Terasen:

Annual Report 2003

reliability starts here:

Terasen

Natural Gas Transmission and Distribution

Terasen Gas is the largest distributor of natural gas in British Columbia, serving approximately 860,000 customers in more than 100 communities. These services are primarily provided by Terasen Gas Inc. and Terasen Gas (Vancouver Island) Inc., both of which also operate transmission systems.

Petroleum Transportation

Terasen Pipelines is one of the largest petroleum transportation businesses in North America. We own and operate Trans Mountain Pipeline – which transports crude oil and refined products from Edmonton, Alberta to Burnaby, British Columbia and delivers Canadian crude oil to several refineries in Washington State – and Corridor Pipeline, a dual pipeline system that transports diluted bitumen and diluent between the Muskeg River Mine near Fort McMurray and the Shell upgrader north of Edmonton, Alberta. We also operate and own a one-third interest in the Express and Platte pipeline systems which transport crude oil from Hardisty, Alberta to the Rocky Mountain region of the United States and on to Wood River, Illinois.

Waterworks and Utility Services

Terasen is the largest private sector provider of water treatment services in Western Canada. Terasen Inc. owns 100 per cent of Terasen Utility Services Inc. – which owns and operates water and multi-utility distribution systems – and Terasen Waterworks (Supply) Inc., which sells products related to the water, wastewater and irrigation industries. We also have investments in companies providing natural gas fueling and customer care services for utilities.

and shows up here

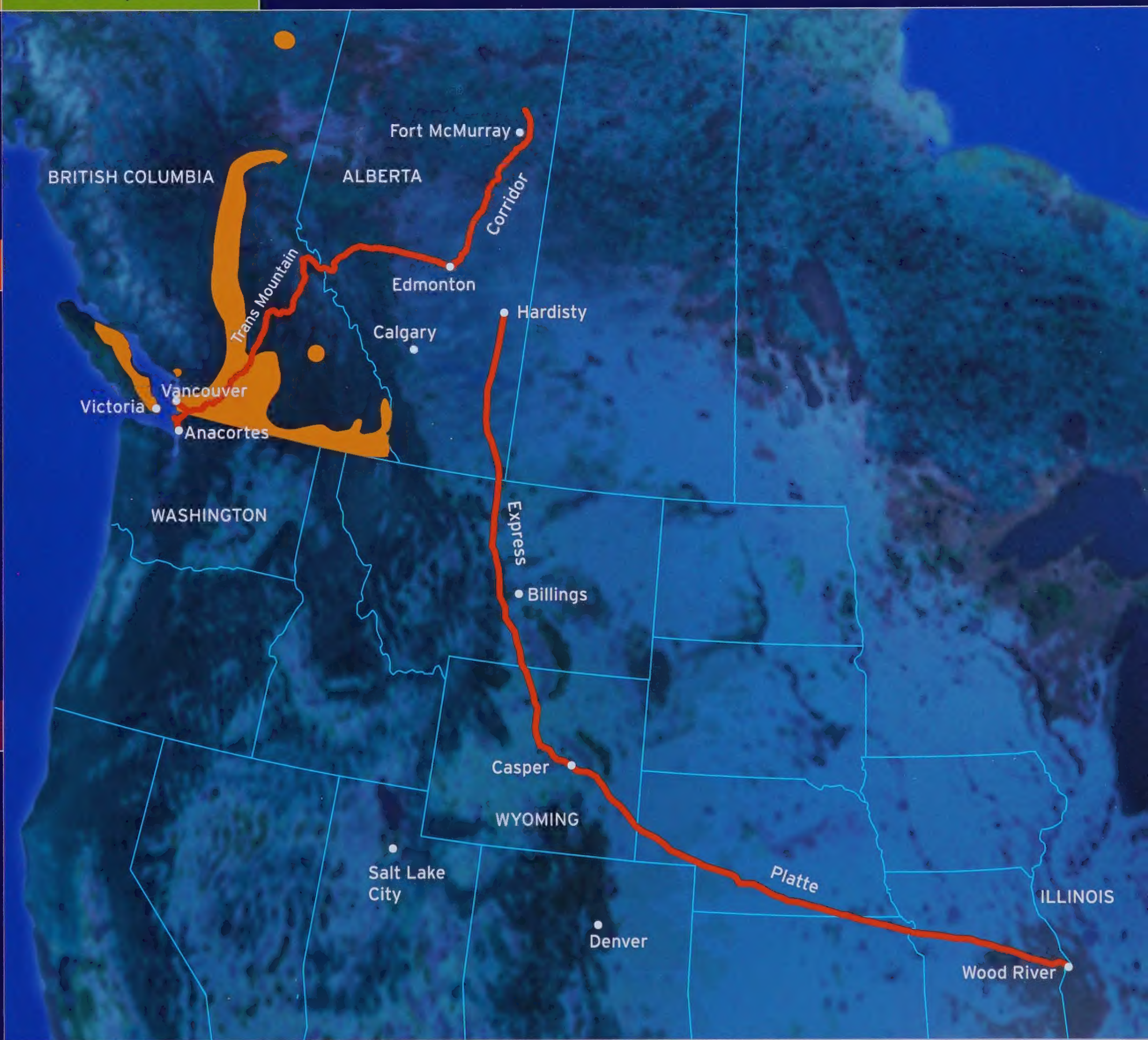
Growth Initiatives

- Proposed expansion of natural gas system to Vancouver Island
- Proposed Inland Pacific Connector Pipeline

- Trans Mountain Pipeline capacity upgrade
- Express Pipeline expansion
- Proposed TMX Project
- Proposed Bison Pipeline
- Proposed Corridor Pipeline expansion

- Operating contracts for water and multi-utility services
- Modest acquisitions of water and wastewater systems

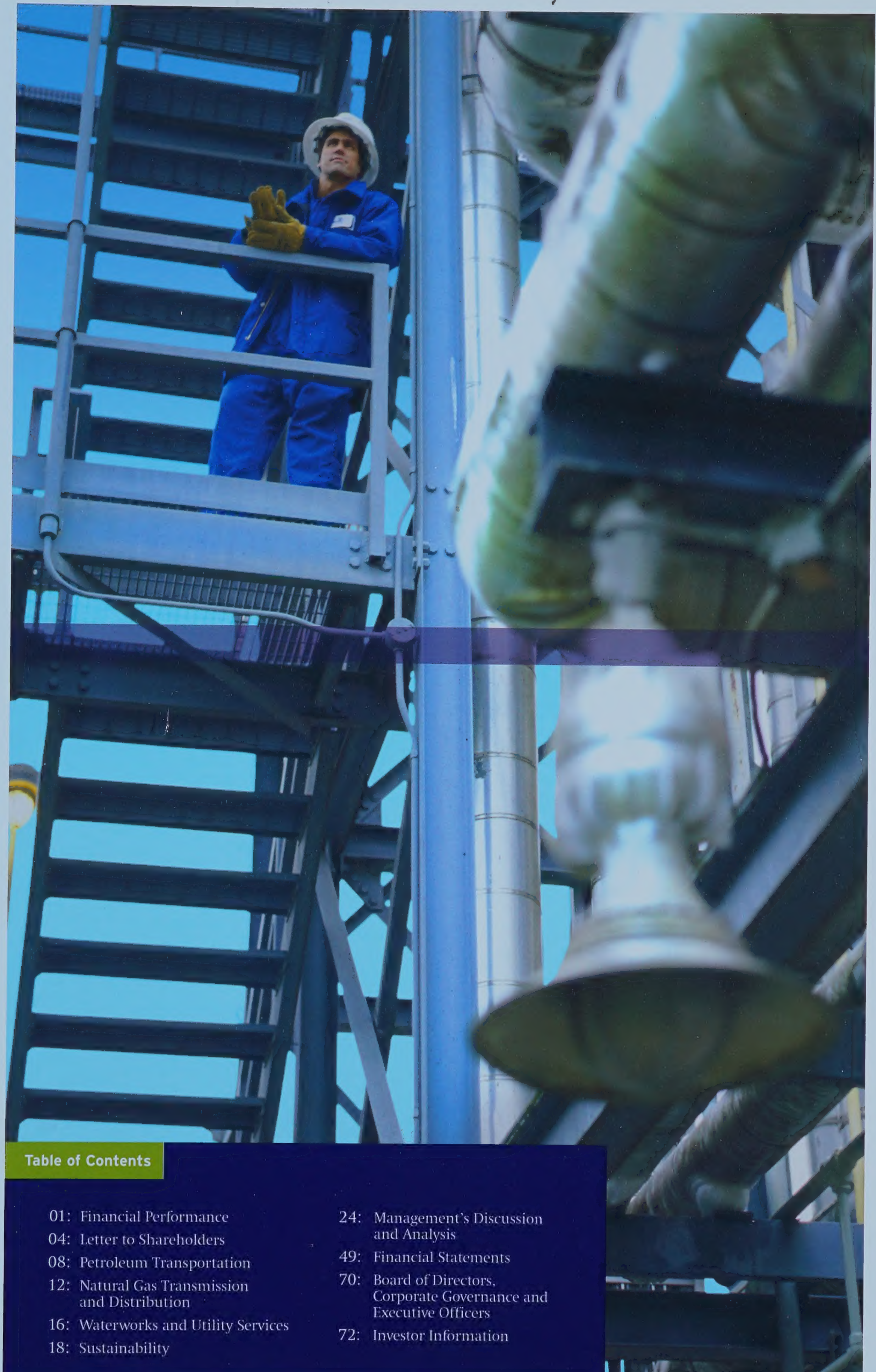
Area of Operations



Natural Gas Distribution
Petroleum Transportation

reliable.

When it comes to the essentials... like home heating, petroleum products and clean water... customers across Western Canada and the U.S. count on Terasen to deliver. Reliable performance is what we're all about – in our services, our operations and our financial results.



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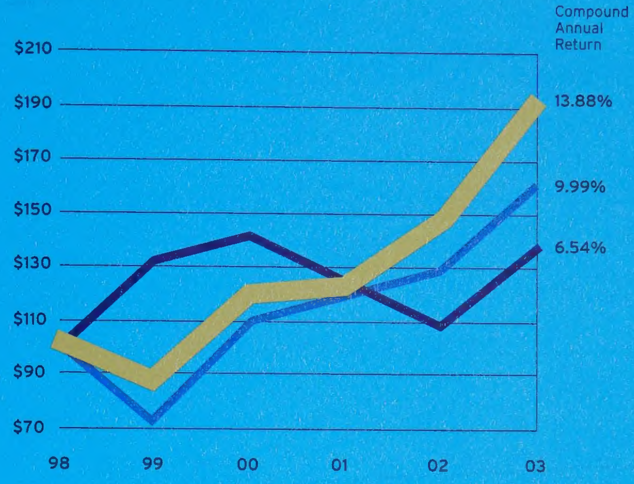
Financial Results

Dollar amounts in millions except per share data

Years ended December 31	**2003**	2002	2001
Gross revenues	**$ 1,876.6**	$ 1,707.2	$ 1,666.3
Earnings before non-recurring items	**136.1**	105.8	84.6
Earnings applicable to common shares	**132.7**	105.8	84.6
Total assets	**4,915.1**	4,522.4	3,705.7
Earnings per share before non-recurring items	**2.62**	2.45	2.21
Earnings per share	**2.56**	2.45	2.21
Dividends per share	**1.53**	1.41	1.30
Book value per share	**25.05**	24.00	18.65
Return on common equity	**10.7%**	11.7%	12.1%

Non-recurring items are material gains or losses that, in management's opinion, are not expected to occur on a regular basis. *Further explanation of non-recurring items can be found on page 37.*

Shareholder Return

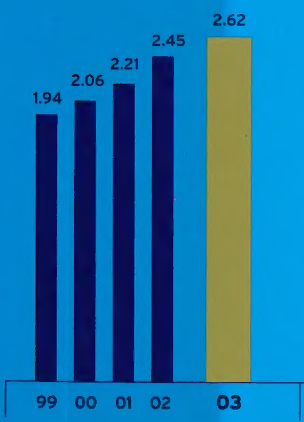


Return on an investment of $100 at December 31, 1998, assuming reinvestment of dividends.

Terasen Inc.
S&P/TSX Composite Index
S&P/TSX Composite Utilities Index

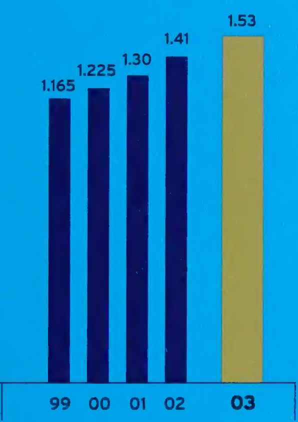
Earnings per Share

Before non-recurring items
Dollars



Dividends per Share

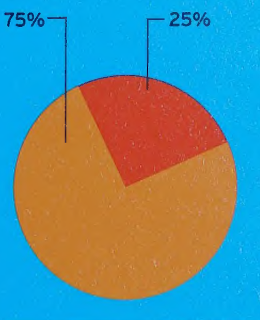
Dollars



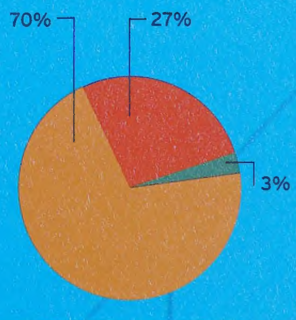
Operating Income in 2003

Assets at Dec. 31, 2003

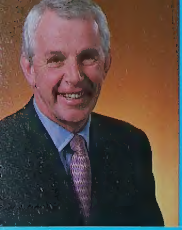
Natural Gas Distribution
Petroleum Transportation
Other Activities

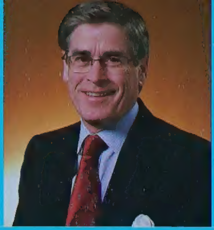


Total: $366.4 million



Total: $4,915.1 million





John M. Reid
President & Chief Executive Officer

Mark L. Cullen
Chairman

Letter to Shareholders

focused.

This is our first letter to shareholders since we changed our company name; we are happy to report we have not changed our story. For a number of years we have been presenting a consistent message to the investment community that our company is about growth based on operational excellence, focused business development and strong financial performance. This year we changed our company name to better reflect where our strategy was taking us but the fundamental story is consistent with years gone by. We are gratified that the execution of the strategy has resulted in another year of strong total returns to investors.

We began the year in the petroleum pipelines business unit by acquiring a one-third interest in the Express Pipeline system to extend our reach into the U.S. mid-west; our Corridor Pipeline began operation in the second quarter; and by year's end we were able to announce that shippers had taken up sufficient capacity for us to plan a rapid expansion of the Express system.

In the gas utilities we were able to negotiate an incentive-based regulatory settlement for the mainland to complement the settlement reached for the Vancouver Island utility in 2003; and, in the fourth quarter, we began merging the two under a single management structure, combining the best attributes of both for greater efficiencies and better service for our customers. Their combined operations are now poised to act on the incentives to grow organically and to compete vigorously for market share of new construction activity.

Our multi-utility business unit began to show promise of considerable growth potential. We added to our water, wastewater and energy distribution assets in the resort sector and we negotiated agreements to operate significant municipally owned water and wastewater utilities. This business has significant potential as local governments come to grips with managing aging infrastructure against increasingly stringent standards.

In an action significant for our shareholders, the Legislature of British Columbia enacted Bill 85 which removed the limitations which had been placed on our share ownership and on our Board membership at the time of the BC Hydro gas assets purchase in 1988. The removal of those restrictions, which no longer carried the relevance they might have in 1988, frees us to use financing arrangements previously unavailable to us and to consider the appointment of directors who might previously have been ineligible. We appreciate the government's action to give effect to these changes.

Creation of shareholder value is the sine qua non by which the year is measured and it is gratifying to observe that once again our performance has resulted in superior returns for our investors. Our earnings per share before non-recurring items were $2.62 compared with $2.45 per share for 2002. The annual dividend rate was increased from $1.44 to $1.56 and the closing price of our shares rose from $38.16 in 2002 to $47.95 on December 31, 2003. That increase in price, combined with the additional 13.3 million shares issued during 2002 to finance the acquisitions of Centra and Express, resulted in a market capitalization of $2.5 billion or almost double that of two years earlier. Our compound annual return to shareholders for the past five years was 13.9 per cent compared with 6.5 per cent for the S&P TSX Composite Index and 10 per cent for the Utilities Index. We appreciate the confidence the market has shown in our business strategy and we intend to stick with it.

OUR BASE BUSINESSES

Natural Gas Distribution

We were very pleased to achieve a four-year regulatory settlement for Terasen Gas which took effect January 1, 2004. The agreement provides us with some certainty and includes incentives to align our interests with those of our customers and to share with them gains from any efficiencies we might obtain while meeting pre-agreed upon levels of service quality.

This agreement complements one previously arrived at by Terasen Gas Vancouver Island covering the period 2003 to 2005 and allows us to integrate the two distribution operations under a single management structure with common business processes. The resulting efficiencies are expected to yield benefits to customers and shareholders alike.

On the mainland our gas purchasing strategy enabled us to apply for and put into effect a rate decrease effective January 1, 2004 that should reduce the typical residential gas customer's annual gas bill by about 7.5 per cent. Uncertainty about the volatility of gas prices in recent years has caused some concerns among potential gas users, particularly in an environment where electricity rates have been kept artificially low by political mandate. Our rate decrease, combined with BC Hydro's interim rate increase of 7 per cent effective April 1, 2004, should improve our competitive position and open some growth opportunities.

While we compete with electricity for market share, we do see a need for increased electricity generation on Vancouver Island and we believe that natural gas-fired generation is the right answer to meet BC Hydro's electricity requirements there. We submitted a proposal to BC Hydro to provide gas to meet their generation requirements using a combination of a liquefied natural gas storage facility on the Island and increased compression and deliverability on our existing pipeline system. The increased throughput would have the added benefit to natural gas customers of lowering the unit cost of gas delivered to the Island. BC Hydro is expected to make a decision about natural gas supply to the Island by August 2004.

Natural gas has become the fuel of choice for generating electricity all over North America placing additional demands on the pipeline infrastructure serving our customers. We continue to work with other gas distribution and power generation companies in B.C., Washington and Oregon to anticipate the growth in demand expected from both traditional gas users and from electricity generators in the region in order to plan for expanding infrastructure to meet the demand before it is on us. Work to date suggests to us that new capacity will be required as early as the winter of 2006/2007. We believe our proposed Inland Pacific Connector, a new pipeline from the Okanagan to the Lower Mainland, will prove to be a key element of the expansion and, in 2003, we completed the first phase of the IPC environmental review process.

Petroleum Transportation

This year, for the first time, we saw our company referred to in the business press as a 'pipeline giant.' While the reference overstates both our position in the petroleum pipeline industry and the weight of pipelines in the asset mix of our company, it did seem to reflect the events of 2003. It is difficult to remember that only one year earlier we were operating only the Trans Mountain pipeline. In January 2003, with our financial partners, we acquired and began operating the Express and Platte pipelines. These lines gave us take away capacity of 172,000 barrels per day from Alberta to two refining areas in the U.S. Rocky Mountain and Midwest regions. The dual pipe Corridor system

We continued to deliver solid financial performance in 2003. Earnings per share before non-recurring items increased 6.9 per cent over the prior year and dividends were up 8.5 per cent.

between the Alberta oil sands and the Edmonton refining area went into service in the second quarter of the year.

By year's end we had gone to open season on the Express system and the response from shippers prompted us to immediately proceed with plans for expansion by 108,000 barrels per day in one phase rather than two.

We began consultations for an initial expansion of the Trans Mountain line of 27,000 barrels per day and by year's end we were in discussions with shippers and government officials about a proposal to loop the entire system in a staged fashion to provide greater access to west coast markets in Canada and the U.S. This proposal will compete with another company's proposal to cut a new right-of-way across central B.C. to tidewater at Prince Rupert as a single project. We believe our staged expansion approach on an existing right-of-way will be the most cost-effective solution for the potential oil shippers.

The Bison Pipeline proposal to provide additional capacity from the Alberta oil sands to the Edmonton refining area continued to be the subject of very active discussions with producers.

While it may yet be premature to refer to our company as a pipeline giant, it is clear that in this business we have many opportunities for significant and rapid growth.

Earnings (Loss) Applicable To Common Shares

Dollar amounts in millions except per share data

Years ended December 31	2003	2003 Per Share	2002	2002 Per Share
Natural gas distribution	**$ 98.8**	**$ 1.90**	$ 92.4	$ 2.14
Petroleum transportation	**56.2**	**1.08**	29.3	0.68
Other activities	**(18.9)**	**(0.36)**	(15.9)	(0.37)
Earnings before non-recurring items	**136.1**	**2.62**	105.8	2.45
Non-recurring items	**(3.4)**	**(0.06)**	—	—
Earnings applicable to common shares	**$ 132.7**	**$ 2.56**	$ 105.8	$ 2.45

Waterworks and Utility Services

In the course of changing the name of our company we found the greatest lack of public awareness was of our water business. We are the largest private sector provider of water treatment services in Western Canada, operating more than 50 water and wastewater treatment systems in B.C. and Alberta. While this business at present represents only three per cent of our assets it offers excellent growth opportunities. To date our greatest success in British Columbia has been in resort communities; however, 2003 saw us in negotiations with more than one municipality to provide water and/or wastewater treatment systems. We expect that these negotiations will result in a number of new contracts in the coming year.

Investments in Other Sectors

We hold investment positions in two external businesses that we were involved in developing and growing. Clean Energy, in which we hold a 44 per cent interest, is North America's largest natural gas fueling company, serving fleets in the taxi, waste removal, transit and airport industries. In 2003, sales volumes of natural gas increased by more than 25 per cent over 2002, due to growing demand for this clean-burning fuel.

We hold a 30 per cent interest in CustomerWorks Limited Partnership, which provides customer care services for utilities, including our own. In 2002, Accenture assumed the responsibility for CustomerWorks operations. Our investment in CustomerWorks provides us with a low-risk way to participate in the growing sector of customer care services for utilities.

Living and Working in our Communities

In the investment community we are measured by the value we add to our shareholders' investments. Other communities measure our performance by how we add that value. It is not enough to earn money; we must earn the confidence and respect of the people and the communities with whom we work. We take pride in the recognition we have received in the aboriginal community: we were named a National Champion at the Aboriginal Human Resource Development Council of Canada's Annual Champions Meeting. In December, Jac Kreut and Randy Jespersen participated in a ceremony celebrating 13 years of working with the Cowichan people and renewed a memorandum of understanding. For the fifth year, the federal government's Voluntary Challenge Registry awarded us gold level reporting status, reflecting our efforts to lower greenhouse gas emissions. These examples symbolize many of the efforts made each year by our employees to make our company a contributor to the communities in which we live and work. We are proud of their efforts.

Changes to the Board of Directors

In December 2003, Iain Harris resigned from our Board. We were sorry to lose Iain. He has made many valuable contributions to the affairs of the Board since joining in 1995, particularly in his role as Chair in 2002 and 2003.

Effective February 29, 2004, David Emerson resigned from our Board. David's public and private sector experience has been a considerable asset to the Board and we will miss his sound advice and counsel. In April 2004, we will lose another long standing Board member with the retirement of Marilyn Cassady. Marilyn has been a Director since 1991 and has been particularly active and made many valuable contributions as Chair of the Environment and Safety Committee.

While we will miss the contributions of the three departing Board members, we look forward to working with our new Board members — Tom Chambers, Pierre Choquette and Eric Newell. Mr. Chambers is a Fellow of the B.C. Institute of Chartered Accountants and brings additional financial expertise to our Board. Mr. Choquette is Chairman & Chief Executive Officer of Methanex Corporation, the world's largest manufacturer and marketer of methanol. Mr. Newell is the former Chairman & Chief Executive Officer of Syncrude Canada Ltd.

In conclusion, we salute and thank our employees in all the business units for their exemplary performance in 2003. Good strategy works only with good execution. Many challenges stood before employees in 2003, particularly with the integration of operations in both the natural gas distribution and the oil pipeline units. They surmounted those challenges and continued to operate at the highest level. Our employees are collectively the keys to our continued success.

We look forward to another successful year in which we again create value for our customers, our employees and our shareholders.

Mark L. Cullen
Chairman

March 1, 2004

John M. Reid
President & Chief Executive Officer

Terasen is a leading provider of energy transportation and utility asset management services.
We create value through operational excellence, strong financial performance and focused business development.

growing.

Growth in our petroleum transportation business capitalizes on increasing production from the Alberta oil sands and enables producers to access new markets from this growing supply.

Petroleum Transportation

We are significantly increasing the size of our petroleum transportation business. Two projects are underway and three others under development to link growing supply from the Alberta oil sands to expanding markets in Western Canada and the Western United States.

In the short term, capacity is being increased on the Express and Trans Mountain pipeline systems. Both currently operate at capacity and can be expanded cost-effectively through the addition of pumping power.

Three major projects are under active development for the longer term: looping the Trans Mountain system to increase volumes sent to Washington State and California, building the Bison Pipeline from Fort McMurray to Edmonton, and increasing the capacity of the Corridor Pipeline to serve Shell Canada's planned expansion of its mine in Fort McMurray.

Expansion of Express Pipeline

In January 2003, we acquired a one-third interest in the Express and Platte pipelines which transport light and heavy oil from Hardisty, Alberta to markets in the Rockies and Midwest regions of the U.S. We also operate and manage the two pipelines.

Capacity is being increased on Express to meet demand for petroleum supply to the Rocky Mountain States and to serve the growing pipeline capacity needs of Western Canadian producers. As a result of significant support from shippers, who have contracted for 70 per cent of the new capacity, the expansion's two phases will be developed concurrently.

The expansion will increase total system capacity to 280,000 barrels per day (bpd) from 172,000 bpd. Nine new pumping stations will be added and ready for service by April 2005.

The strong shipper support validates our strategy of capitalizing on the growth opportunities arising from the Alberta oil sands and our approach of addressing shippers' transportation needs by providing pipeline capacity and cost-efficient operations. Suncor, for example, will rely almost completely on its oil sands production in Fort McMurray to operate its recently purchased refinery in Denver. The Express expansion will facilitate the movement of Suncor's synthetic crudes into their Denver refinery as well as to other markets in the Midwest.

The acquisition of an interest in the Express Pipeline System in early 2003 significantly increased the size of our petroleum transportation operations.

The Express expansion will secure delivery options for U.S. refiners who are investing in refinery infrastructure to meet new regulations that will come into effect in 2005 for low-sulphur gasoline and 2006 for low-sulphur on-road diesel. Expansion will enable the Express system to ship more synthetic crude oil, assisting refiners to meet the new regulations through the availability of low-sulphur feedstocks.

Total deliveries on the Express and Platte pipeline systems averaged 214,000 bpd for the past year, up four per cent from 2002. Express receipts at Hardisty were 171,200 bpd, up 4,200 bpd from 2002. These higher volumes reflect increasing crude oil supply from Western Canada and increasing demand for oil in the markets the Express system serves.

Upgrading Trans Mountain's Capacity

We are in the process of upgrading capacity on the Trans Mountain system — the only petroleum pipeline connecting Alberta to the West Coast — to meet increasing market demand for Alberta crude oil in Washington State and California.

The upgrade will increase capacity by 27,000 bpd and involve repowering existing pump stations and reactivating a pipeline loop between Darfield and Kamloops. The expansion is scheduled to be operational in September 2004, subject to regulatory approval.

In 2003, deliveries on the Trans Mountain mainline system were 216,100 bpd compared with 201,200 bpd in 2002. As with Express, the higher volumes reflect growing Western Canadian oil sands production and increasing importance of this production to U.S. markets.

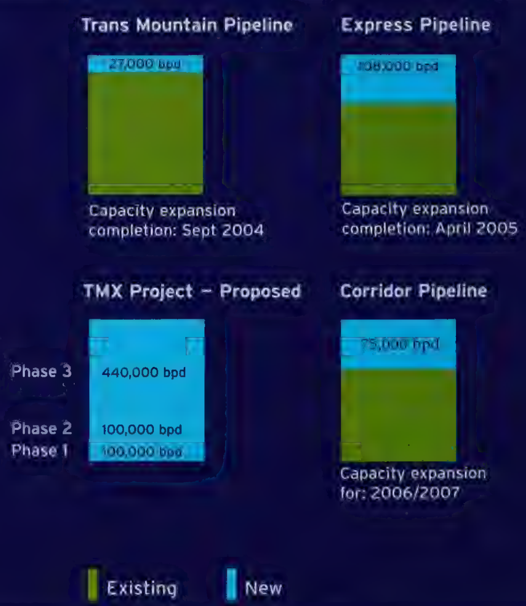
Planned TMX Project

We are planning to expand along the route of our Trans Mountain system. The "TMX Project" would involve adding pipeline loops, new pump stations and storage facilities to the Trans Mountain system in three phases. Project phasing lowers risk by allowing

Proposed Bison Pipeline

Capacity Additions

Expansions of Trans Mountain and Express are underway. We are also proposing to build two new pipelines — Bison and TMX — and to increase capacity of the Corridor system.



capacity to be added in stages to meet market requirements and production growth.

The TMX Project also builds on our existing export business through Westridge Terminal and to Washington State, and leverages our proven expertise in building and operating pipelines through mountainous terrain. We successfully constructed Southern Crossing Pipeline across southern British Columbia in 2000 and have operated the Trans Mountain system – which crosses four mountain ranges – for more than 50 years.

Proposed Bison Pipeline

The proposed Bison Pipeline is designed to meet the needs of multiple shippers by transporting both synthetic crude oil and diluted bitumen from the Athabasca oil sands deposit to Edmonton.

Edmonton is Western Canada's oil operation hub, with a large refinery base and pipeline system access to all North American crude oil markets. Bison would be developed adjacent to our existing rights-of-way and take advantage of our experience gained in constructing Corridor Pipeline.

Corridor Pipeline Successfully Completed

Corridor Pipeline, completed on-time and on-budget, successfully started commercial operation in May 2003. Corridor meets the needs of Shell Canada and its partners Western Oil Sands and Chevron Canada – who developed the Athabasca Oil Sands Project (AOSP) – by connecting AOSP's Muskeg River Mine north of Fort McMurray to the project's upgrader adjacent to Shell's Scotford Refinery near Edmonton.

Shell is considering expanding the mine in 2006/2007, and Corridor Pipeline will be expanded at the same time to meet the need for increased capacity.

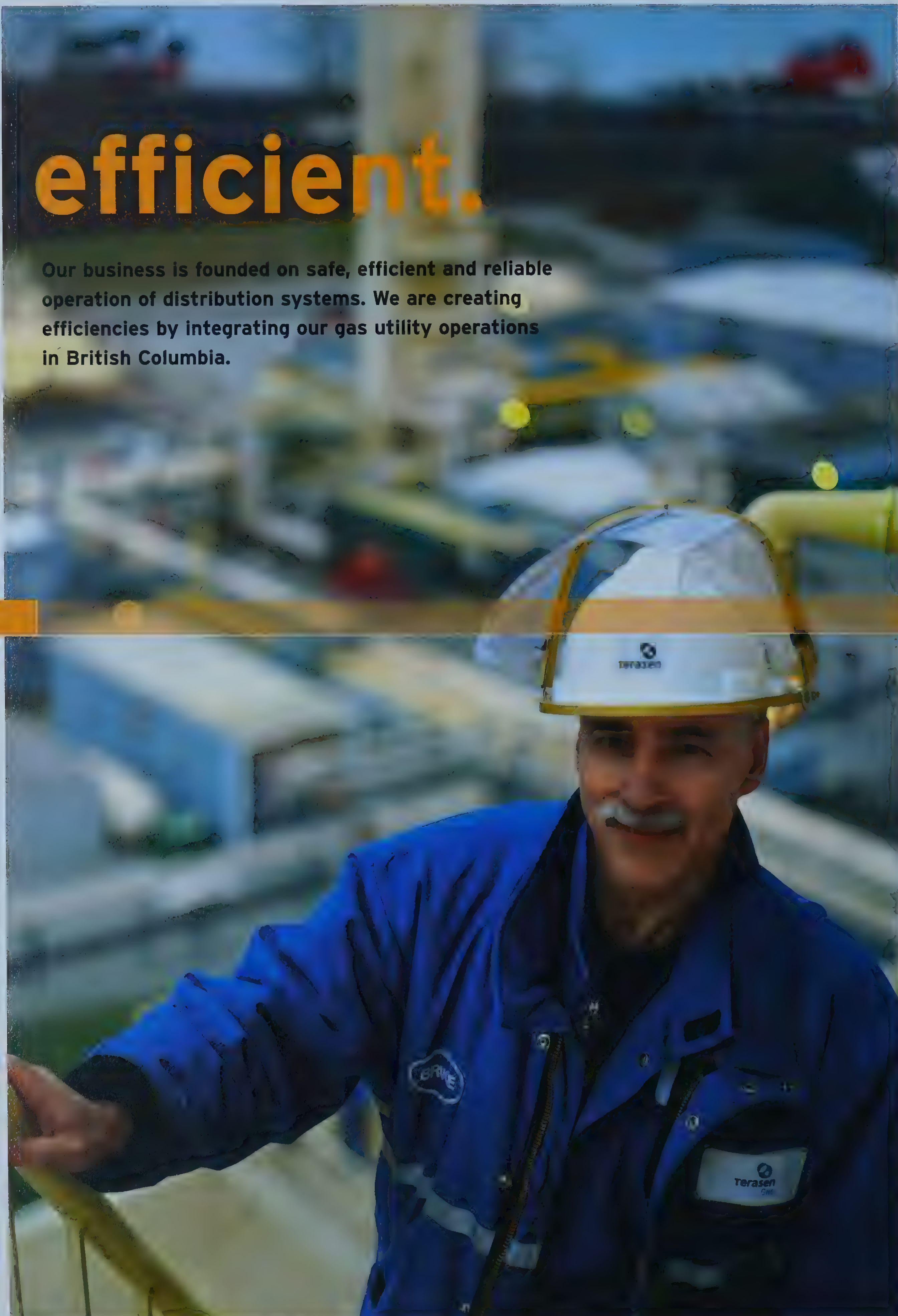
Since start-up, diluted bitumen deliveries from the mine into the upgrader averaged 133,000 bpd, of which 51,000 included diluent returned to the mine site.

Western Canadian oil production is expected to grow from 2.2 million barrels per day in 2002 to 3.1 million barrels per day by 2010. Most of this production growth is from the Alberta oil sands.

Petroleum Transportation

efficient.

Our business is founded on safe, efficient and reliable operation of distribution systems. We are creating efficiencies by integrating our gas utility operations in British Columbia.



Natural Gas Transmission and Distribution

We negotiated a four-year performance-based regulatory settlement for Terasen Gas and are realizing efficiencies from integrating our gas distribution operations on the B.C. mainland and Vancouver Island. During the year, we submitted a proposal to expand capacity to deliver natural gas for potential new gas-fired power generation on Vancouver Island.

Performance-Based Regulation

A four-year regulatory settlement – covering 2004 through 2007 – took effect for Terasen Gas Inc. on January 1, 2004. This settlement, negotiated between Terasen and representatives of our customers and other stakeholders, outlines a process for determining delivery charges to our B.C. mainland customers over a four-year period. Aligning our interests with those of our customers, the settlement provides us with incentives to pursue additional initiatives to improve capital and operating efficiencies and includes 10 service quality measures designed to ensure we maintain our service levels. The settlement is in line with the move towards performance-based regulation outlined in the provincial government's energy policy. It's also consistent with our preference for regulatory agreements that are outcome-based – focused on competitive price and the quality of service delivered to customers. We have operated under negotiated settlements and performance-based rates since 1993.

A three-year regulatory settlement took effect for Terasen Gas (Vancouver Island) Inc. (TGVI) on January 1, 2003, covering the period through 2005. This settlement reconfirmed the previous incentive-based agreement where both customers and TGVI benefit from operating efficiencies.

The new settlements enabled us to integrate our gas transmission and distribution operations on the mainland and Vancouver Island as of January 1, 2004. Combining the best elements from both entities, we now have a single management group and are moving quickly to shared business processes and technology platforms. While we will continue to have separate regulatory arrangements for Terasen Gas (British Columbia mainland) and TGVI (Vancouver Island/Sunshine Coast), the two entities are adding value to both customers and shareholders from integration, with reduced overhead, greater economies of scale, shared knowledge and best practices.

Rate Decrease

A rate decrease for our mainland B.C. customers took effect on January 1, 2004. As a result, a typical residential customer's annual gas bill will be reduced by about 7.5 per cent, depending on consumption level. The rate changes are made up of a nine

Terasen provides natural gas service to approximately 780,000 customers on the B.C. mainland and 79,000 on Vancouver Island, the Sunshine Coast and Whistler.

per cent decrease in the commodity price of natural gas and a 1.5 per cent increase in delivery charges.

Our gas purchasing strategy has helped us ride out volatility in the market and lock in prices for a significant amount of the gas required by our customers. This allows us to reduce the rate our customers pay for the commodity and provides a high degree of certainty to consumers that gas rates will remain competitive with electricity rates, which in B.C. are among the lowest in North America. We protect customers from escalating prices by storing gas during times of low demand (for example the summer) for use at a later date (such as in the winter, when gas prices are typically higher). The cost of natural gas flows directly through to the customer without markup.

Proposal to Expand Capacity to Vancouver Island

We submitted a proposal to BC Hydro to provide natural gas for potential new gas-fired electric generation facilities on Vancouver Island. The proposal is part of a review by BC Hydro of different options to address electricity demand and reliability issues on the Island. Our proposal includes a liquefied natural gas (LNG) storage facility to meet residential peak day requirements and additional compression and delivery capacity on our natural gas pipeline to help meet the base load requirement of one or more power generation facilities. These two approaches can be done cost effectively and on a timely basis.

Since our proposal involves modifying existing systems, we believe we offer the most cost-effective means of providing additional gas to the Island while minimizing undesirable social and environmental impacts. It will also benefit existing and prospective customers by reducing the unit cost of delivered gas to the Island.

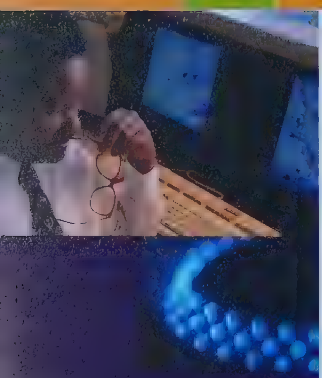
Gas-fired power generation offers a reliable and practical means of meeting the Island's electricity requirements. BC Hydro is expected to make a decision about natural gas supply to Vancouver Island by August 2004.

Inland Pacific Connector

In 2003, we completed the first phase of the provincial environmental review process on the proposed Inland Pacific Connector, a 237-kilometre pipeline between Oliver in the South Okanagan and Huntingdon in the Fraser Valley. This pipeline would provide increased natural gas supply to southwestern B.C. and the Pacific Northwest.

At present, regional economic conditions have reduced the immediate need for new capacity; however, the Inland Pacific Connector project is well positioned to respond to the marketplace as demand for natural gas grows.

Electric and gas distribution companies in British Columbia, Washington State and Oregon are working together to evaluate and plan for the anticipated growth in demand for residential, commercial and industrial gas supply in the region. A report prepared by a leading consulting firm indicated that the Pacific Northwest faces capacity challenges, and may not have enough supply during periods of water shortages or colder than average winter conditions. We believe this supports the need for new capacity as early as the winter of 2006/2007.



Our purchasing strategy allows us to reduce the rate our customers pay for natural gas. The cost of natural gas flows directly through to the customer without markup.

Helping Our Customers Become More Energy Efficient

For the second year in a row, we partnered with Natural Resources Canada to offer customers a $300 credit toward the cost of upgrading their home heating system to an ENERGY STAR® qualified high-efficiency natural gas furnace or boiler. And in cooperation with Natural Resources Canada, BC Hydro PowerSmart, and Aquila Networks, customers received an additional $150 rebate when the qualifying furnace included a high-efficiency variable speed fan motor. This latter offer encouraged customers to continue to use natural gas for space heating while reducing the amount of electricity used by the furnace. Approximately 2,900 customers residing on the B.C. mainland participated in these 2003 programs.

Along with similar rebate offers for customers on Vancouver Island, these demand side management efforts encourage energy conservation, reduce greenhouse gas emissions, and help homeowners control their heating costs.

Natural Gas Transmission and Distribution

- Terasen Transmission Lines
- Terasen Distribution Service Area
- Other Natural Gas Lines
- Proposed Inland Pacific Connector Pipeline
- Proposed LNG Storage Facility

If we are selected to provide natural gas for electric generation on Vancouver Island, we would develop a liquefied natural gas storage facility to store surplus natural gas in the summer for customers' winter gas requirements.

resourceful.

We significantly expanded our water business during the year and continue to develop our multi-utility services. These businesses build on our core competencies of safe, efficient and reliable operation of distribution systems and represent a solid platform for growth.

Terasen is the largest private sector provider of water treatment services in Western Canada, operating more than 50 water and wastewater treatment systems in B.C. and Alberta.

Growing our Water and Sewer Business

Over the past several years, we have been applying our core strengths in distribution operations to the water and wastewater business. We are now the largest private sector provider of water and wastewater products and services in Western Canada and operate more than 50 water and wastewater systems throughout B.C. and Alberta. This market has strong growth potential because of the ongoing need to upgrade infrastructure and invest in new technology to ensure safe and reliable provision of water and treatment of wastewater.

We are expanding our activities to cover the full range of water and wastewater distribution system services and treatment plant operations.

During the past year, we were selected by a British Columbia municipality to operate its sewer system under a long-term contract. We are in discussions with a number of other municipalities and communities to offer similar services for their sewer and water systems.

In January 2004, we acquired ImServ, a business that provides third-party metering services for natural gas, electric and water utilities throughout the United States. We are in the process of combining this with our Canadian meter initiatives to create one of North America's largest meter services businesses. This acquisition expands our competencies to provide automatic meter reading, meter deployment, meter fleet management and multi-utility meter reading for municipalities and utilities throughout North America.

Operating Multi-Utility Systems

We continue to leverage our core competencies to grow our business in off-grid and non-regulated utility services and to bundle our operations and maintenance services for water, sewer, gas and other utilities into multi-utility systems. In October 2003, we purchased the propane, water and wastewater utility assets of Toby Creek Utilities, which provide service to Panorama Mountain Resort in eastern British Columbia. We now both own and operate the Toby Creek Utilities assets. We also provide utility and energy services for Silver Star Resort, Sun Peaks and a number of smaller resort and lifestyle-oriented communities.

Terasen Utility Services provides services and products to contractors, builders, developers, resorts, institutions and municipalities.

Investments in Growing Sectors

We hold an investment position in two external businesses that we were involved in developing and growing.

We hold a 44 per cent interest in Clean Energy, the largest natural gas fueling company in North America, serving fleets in the taxi, waste removal, transit and airport industries. Clean Energy has expanded considerably over the past few years, adding new fueling stations and increasing sales volumes. In 2003, sales volumes of natural gas increased by more than 25 per cent over 2002, due to growing customer demand for this clean-burning fuel.

Terasen also has a 30 per cent interest in CustomerWorks Limited Partnership, which provides customer care services for utilities. In 2002, Accenture assumed the responsibility for CustomerWorks' operations. Our investment in CustomerWorks provides us with a low-risk way to participate in the growing sector of customer care services for utilities.

The water and sewer industry is being transformed with the advent of new technology to provide quality services and water. Terasen is focused on providing services to the large and growing water sector.

responsible.

We are developing a company-wide approach to sustainability, based on the strengths of our businesses.

Sustainability

Good corporate citizenship is fundamental to the way we do business. Our approach to sustainable growth ensures that social, environmental and safety considerations guide our decision-making process and form the foundation of our actions. We invest in the communities where we operate to create stronger, healthier and safer places to work and live.

At Terasen, we work hard to generate value for all of our stakeholders — by delivering solid economic performance, by being a respected corporate citizen, continually improving our safety and environmental performance and creating an environment where employees can best use their talents to achieve goals that benefit our customers and our Company.

Community Environmental Project Outreach Program

Our Community Environmental Project Outreach initiatives make a unique contribution to community-based environmental activities. By partnering directly with community groups, we are participating in long-lasting environmental and stewardship projects.

In 2003, we worked with the Fanny Bay Salmonid Enhancement Society to safeguard salmon habitat on Wilfred Creek on Vancouver Island. Our participation involved removing a collapsed bridge, protecting the site and water levels through rock placement, restoring a failed beaver protection device and repairing bank erosion around a pipeline.

Reducing Emissions

For the fifth consecutive year, Terasen Gas was awarded gold level reporting status from the Voluntary Challenge and Registry (VCR) reflecting our efforts to manage and reduce greenhouse gas emissions. The VCR ranking acknowledges our success in developing specific measures and voluntarily setting reduction targets.

For the most recent reporting period, we reduced our operating emissions to 5.8 per cent below 1990 levels. Greenhouse gas offsets yielded a further 2.7 per cent reduction, for a total reduction in operating emissions of 8.5 per cent below 1990 levels.

In 2004, Terasen Pipelines will begin a partnership with the City of Calgary's Forever Green Program, a city-wide initiative where Calgarians of all ages voluntarily plant trees to beautify neighbourhoods, increase the urban forest canopy and create positive environmental benefits.

Our company-wide health, safety and environmental policy governs the operations of our petroleum transportation, natural gas distribution and waterworks and utility services businesses.

This program complements our ongoing support of Tree Canada, a national initiative that encourages Canadians to plant and tend trees as a way of offsetting the impacts of carbon dioxide emissions.

New Technology Improves Water Quality Testing

Technology is essential for measuring and maintaining water quality. In 2003, we acquired the exclusive rights to distribute Joule Microsystems' on-line biological sensor and monitoring system to water utilities and industry in B.C. and Alberta. In addition to offering rapid response services, we now provide a higher standard of around-the-clock water monitoring. The application of this technological advancement raises the bar for water quality monitoring and improves public safety, ensuring that a community's water supply meets the required health standards.

Consulting with Our Stakeholders

We are committed to clear and open consultation with our stakeholders. As part of this commitment, we are involved in ongoing communication with local communities to respond promptly to their concerns and to communicate openly about our activities and their impact on health, safety and the environment. Our priorities are to distribute project information, collect local input and feedback and to seek public acceptance and consensus through dialogue with interested parties.

The wildfires of August 2003 in B.C.'s interior demonstrated our capacity to respond to emergency situations. While maintaining the integrity of our natural gas distribution, energy utility and liquid petroleum pipeline assets, Terasen provided critical assistance to the Provincial Emergency Program and the local Emergency Operations Centres in the Barriere, Kamloops, Kelowna and Cranbrook regions. Our logistical and community support during this difficult time were acknowledged by the provincial emergency agencies, the Thompson Nicola Regional District and the Oil and Gas Commission.

During the past year, we conducted an active public consultation program on Vancouver Island to discuss our proposal to upgrade our system to meet current and future natural gas demand requirements on the Island. The proposal involves constructing a liquefied natural gas (LNG) facility, adding compressors and installing pipeline looping. This initiative has generated public interest and widespread support.

Our petroleum transportation business continues to seek new opportunities to capitalize on growing oil sands production. Proposed initiatives such as the Heartland Terminalling facility near Edmonton, the looping of the Trans Mountain system and the Bison Pipeline will include a comprehensive public consultation program as part of the projects' planning and information gathering phase.

Upgrading the Fraser River Pipeline Crossing

In 2003, as part of our petroleum pipeline integrity management program, we replaced a 1.2-kilometre section of pipe under the Fraser River that connects the municipalities of Surrey and Coquitlam. The $11.5 million seismic upgrade placed the pipeline in deeper and more

stable soils to improve pipeline resistance in the event of an earthquake. The horizontal drilling technology used to complete the upgrade has less environmental impact than more conventional "open trench" methods and avoided disrupting residential areas on the Surrey side of the river. Public consultation was a key part of the project, including notification to residents and an open house.

Pipeline Integrity Hydrostatic Test in Washington State

Hydrostatic testing – where the pipeline is pressure tested with water – is also a part of Terasen Pipelines' ongoing pipeline integrity management program. In conjunction with other tests, such as high-resolution in-line inspections, hydrostatic testing is an important tool to confirm the pipeline's integrity.

In May and June of 2003, we completed hydrostatic testing of the pipeline system running through Whatcom and Skagit counties in Washington State. In support of the test, a comprehensive communications and public safety program was implemented to increase awareness and minimize disruption to local residents and services.

Celebrating a 13-Year Partnership

Terasen Gas' 13-year working relationship with the Cowichan Tribes of Duncan was strengthened this year when we renewed a memorandum of understanding outlining the social and economic benefits for both parties. This agreement builds on the original letter of agreement, signed in 1990, that addressed the rights-of-way for installing a natural gas pipeline through traditional Cowichan territory. Since then, members of the Cowichan Tribes have played an important role in helping construct natural gas distribution pipelines.

For the past eight years, the pipeline division of a Cowichan-owned company has installed distribution mains and provided services for Terasen Gas and its predecessor companies in the Greater Victoria area, and has completed work elsewhere on Vancouver Island, the Sunshine Coast and the Resort Municipality of Whistler.

We are continuing to foster similar mutually beneficial and positive business relationships with other Aboriginal communities in our service territory.

Educating the Public about Natural Gas Safety

Since 1999, Terasen Gas has worked closely with British Columbia Fire Services to increase the public's understanding of gas safety and emergency preparedness.

In 2003, our gas safety messages were integrated into the Fire Services' new *Getting to Know Fire* Public Fire and Life Safety Education Curriculum. Published by the Office of the Fire Commissioner, *Getting to Know Fire* includes interactive learning materials for children from preschool to Grade 12 and for seniors and special interest groups. Terasen Gas developed components of the curriculum focusing on natural gas safety information: what natural gas smells like and what you should do when you smell it, carbon monoxide safety and emergency/earthquake preparedness information. During the year, we participated in workshops that

We are adopting a consistent and cohesive approach to sustainability across all of our businesses.

presented *Getting to Know Fire* to firefighters across the province. In addition, we supplied brochures and posters on natural gas and carbon monoxide safety to B.C.'s fire departments.

Terasen Gas is also the new sponsor of the British Columbia Fire Services' Comfort Pup Program. This initiative provides plush toy Dalmatian puppies to firefighters for distribution to children who have experienced trauma.

Employee-Led Programs Strengthen Communities

Warm Hearts, a program developed and managed by Terasen Gas employees, supports the health and well-being of the communities where Terasen employees live and work. Since the program was created in 1994, Terasen employees have donated more than $300,000 towards important initiatives that strengthen communities.

In 2003, Warm Hearts partnered with the United Way of the Lower Mainland to support Success by 6, a program dedicated to giving children from birth to age six the foundation they need to get a good start in life and reach their full potential. Warm Hearts' donation of $75,000 over three years will enhance services at two family resource programs, ensuring stable support is in place for thousands of families in the Lower Mainland. This donation will be matched by the United Way.

Warm Hearts also contributed $15,000 to the Langley Hospice Society, which provides palliative care services to those facing life-threatening diseases. A donation of $5,000 to the Fort Nelson General Hospital — B.C.'s most northerly hospital — was used to purchase furnishings for patient rooms.

A new community investment initiative, launched by Terasen Pipelines' employees in 2003, distributes a portion of funds raised at company events to charitable organizations located in communities where Terasen Pipelines operates. The recipients will be organizations that meet our community investment focus in education, environment or safety. During the year, funding was provided to charitable organizations in Holdredge, Nebraska; Fremont County, Wyoming; Bridger, Montana and Calgary, Alberta.

Terasen employees are long-standing supporters of the United Way. Our employees continued to have high participation rates in the 2003 United Way campaign.

Connecting Communities with the Trans Canada Trail

On July 13, 2003, Terasen Pipelines officially added 27 kilometres to the Trans Canada Trail network by opening a pipeline service road to public access.

Over 300 cyclists, equestrians, joggers and hikers gathered at the start of the new trail just off B.C.'s Coquihalla Highway. The access road, which stretches between Britton Creek and Portia, was formerly part of the Kettle Valley Railway. When the railway shut down, Trans Mountain acquired the rail bed to allow maintenance vehicles to access the pipeline right-of-way. It now forms a valuable part of this national trail that will pass through every province and territory in Canada, linking hundreds of communities along its route.

Terasen was one of seven Canadian companies who qualified as a Triple Crown Winner in Corporate Knights' 2004 Responsible Investing Survey. Triple Crown recognizes companies who are included in a number of indices, including the Dow Jones Sustainability Index and the 2003 Corporate Knights Best 50 Corporate Citizens in Canada.

The Dow Jones Sustainability World Index ranked Terasen third in the world among gas distribution utilities for sustainability performance in 2003.

We're helping to link the Trans Canada Trail across British Columbia. In past years, Terasen has provided funds for the trail in the Kootenay Boundary Area in southern B.C. and the Galloping Goose Trail on Vancouver Island as well as on Burnaby Mountain.

Educational Support

As part of our commitment to education, Terasen provides annual bursaries for students at post-secondary institutions across British Columbia. In 2001, we pledged $215,000 over five years to the Chinook Program at the University of British Columbia's Sauder School of Business. This program offers First Nations students an undergraduate education in management and entrepreneurship tailored to their specific interests and needs.

Every year, Terasen Pipelines provides bursaries to post-secondary institutions along the Trans Mountain and Corridor pipeline systems, including universities, technical institutes and community colleges. Bursaries are then awarded to students studying in the areas of science, engineering and technology and are based on academic standing and demonstrated financial need. In 2003, 14 post-secondary institutions in Canada and four in the United States received bursaries. We have also set up bursaries with eight U.S. educational institutions along the Express and Platte pipeline systems.

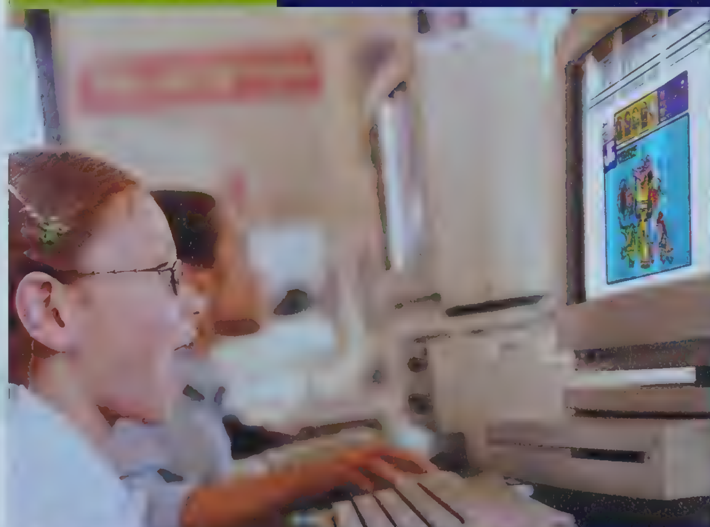
Buffalo Sponsorship in Casper, Wyoming

During the year, Terasen Pipelines participated in *Where the Buffalo Roam*, a fundraising project developed by the Nicolayson Art Museum in Casper, Wyoming. Organizations sponsored 30 "buffalo" creations that were displayed around Casper prior to auction at the end of the summer. Terasen's buffalo featured a map of the state of Wyoming.

Trans Mountain Pipeline System Celebrates 50 Years

Since it began operations in 1953, the Trans Mountain pipeline system has played a vital role in transporting petroleum products from Alberta's oil fields to refineries on the West Coast and to offshore markets. Throughout its 50-year history, the Company has always placed the highest priority on safety, reliability and environmental protection.

A Website for Kids



In 2003, we launched a website to educate children and their families about natural gas safety. The new website presents information on safety, the environment and greenhouse gases – as well as where gas comes from and how it gets into people's homes – in a fun and interactive style that appeals to children. "Terasen Junior" has hundreds of online visitors each month. You can visit the site at www.terasenjr.com.

Performance Highlights – provides an overview of the financial and operational achievements of 2003 and a look ahead at the opportunities for 2004.

About Terasen – describes Terasen's vision, core businesses and strategy. It also reviews the key performance drivers, which includes a discussion of regulatory arrangements, risk management, asset management, business development and access to capital.

Financial and Capital Management – provides a detailed discussion of how we manage our financial and capital resources.

Financial Results – provides a comparative review of the financial performance for the consolidated Company over the past two years. It also provides an analysis of the performance of the separate business units.

Business Development – reviews the Company's activities with regard to system expansions and growth by acquisition.

Risk Assessment – describes the key risk factors that could affect our business.

New Accounting Policies – provides a summary of the new or pending accounting policies that may have an impact on the Company's financial reporting.

PERFORMANCE HIGHLIGHTS

REVIEW OF 2003

Terasen continued its consistent delivery of financial and operational success in 2003. Earnings per share before non-recurring items grew by 6.9 per cent and dividends per share grew by 8.5 per cent. In addition to its financial success, the Company continued to pursue growth opportunities, while maintaining its low risk profile. Significant achievements for Terasen in 2003 include:

- British Columbia Utilities Commission (BCUC) approval of a negotiated settlement of a 2004–2007 Performance-Based Rate Plan (PBR Settlement) for Terasen Gas.
- BCUC approval of a 2003–2005 regulatory settlement for TGVI, which extends its incentive mechanisms.
- Initiation of commercial operations of the Corridor Pipeline in May following the on-time, on-budget completion of its construction.
- Completion of the acquisition of a one-third interest in the Express Pipeline System and shipper support for the expansion plans for that system.
- Initiation of the expansion on the Trans Mountain pipeline which will provide an additional 27,000 bbl/day (barrels per day) of capacity.

This discussion should be read in conjunction with the consolidated financial statements of the Company and related notes for the years ended December 31, 2003 and 2002. In this MD&A, we, us, our, the Company and Terasen mean Terasen Inc., its subsidiaries, joint ventures and investments in significantly influenced companies. Terasen Gas refers to Terasen Gas Inc., TGVI refers to Terasen Gas (Vancouver Island) Inc., Trans Mountain refers to Terasen Pipelines (Trans Mountain) Inc., Corridor refers to Terasen Pipelines (Corridor) Inc., Terasen Pipelines refers to Terasen Pipelines Inc., Express System refers to the Express and Platte Pipeline Systems, Bison refers to Terasen Pipelines (Bison) Inc. and TMX refers to the proposed looping project of the Trans Mountain mainline.

OUTLOOK FOR 2004

Terasen continues to execute its focused strategy of delivering consistent and sustainable growth through investments in low risk businesses. From projects such as the expansion of the Express and Trans Mountain pipelines to solutions for the delivery of additional natural gas to Vancouver Island, the Terasen group of companies is positioned to meet the growing needs for natural gas and petroleum transportation in North America.

One of the key objectives for Terasen Gas in 2004 will be to capitalize on the efficiencies to be achieved from the operational integration with TGVI. A regulatory framework has been established that provides the opportunity to create value for both customers and shareholders by achieving operating efficiencies. Terasen Gas will also continue to pursue opportunities such as the construction of additional gas transportation capacity and will work with Island communities and stakeholders to support the installation of a liquefied natural gas storage facility on Vancouver Island to best serve existing customers and new gas-fired power generation.

In petroleum transportation, Terasen will continue to capitalize on the unique opportunity presented by the growth in production in Western Canada. The Company is working closely with the shipping community to provide transportation solutions evolving from growth in the Alberta oil sands. During 2004, Terasen will make investments in the expansion of the Express and Trans Mountain pipeline systems. The Company will also pursue opportunities related to the development of the Bison pipeline and the TMX project for the eventual looping of the Trans Mountain pipeline.

Looking ahead to 2004, we believe we are well-positioned to continue to deliver consistent growth in earnings. The platform for operating efficiencies and organic growth has been set to enable us to achieve our targeted growth in earnings per share of 6%. In 2005, organic growth should continue to drive financial success as we begin to reap the benefits generated from the expansion of the Express and Trans Mountain pipelines.

When used in this report, the words "anticipate," "expect," "project," "believe," "estimate," "forecast" and similar expressions are intended to identify forward looking statements, which include statements relating to pending and proposed projects or possible acquisitions. Such statements are subject to certain risks, uncertainties and assumptions pertaining to operating performance, regulatory parameters, economic conditions and, in the case of pending and proposed projects, risks relating to design and construction, regulatory processes, obtaining financing and performance of other parties, including partners, contractors and suppliers and in the case of possible acquisitions, obtaining financing, acquiring assets or companies at an appropriate price and the ability to effect synergies in a timely and cost-effective manner.

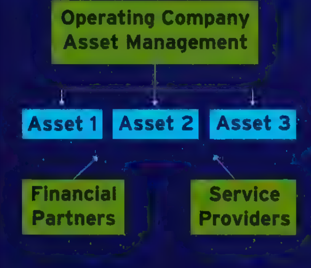
ABOUT TERASEN

VISION

Terasen's vision is to be a leading provider of energy transportation and utility asset management services. Our core competency is the provision of operating services associated with gas distribution, petroleum transportation and water distribution. We create value by bringing a combination of operational excellence, financial excellence and focused business development to the provision of these services. We manage assets which we either own exclusively or which (in the case of the Express System) we co-own with financial partners. Scale efficiencies are created by consolidating the provision of operating services of separately regulated entities into single larger operating companies — Terasen Gas in the gas distribution business and Terasen Pipelines in the petroleum transportation business.

Operational Excellence

The safe, reliable, cost-effective and environmentally responsible provision of energy transportation services is at the core of our continuing drive to improved levels of operational excellence in our businesses. Our regulated businesses operate under performance-based regulatory arrangements, which incent continuous improvement in operating excellence. Benefits from these efforts are shared between customers and shareholders.



The asset manager model enables Terasen to achieve operating efficiencies from separate regulated entities.

Financial Excellence

Terasen creates value by matching infrastructure assets with the lowest possible cost of capital. Terasen has in place a cost-efficient capital structure that maintains reliable access to capital markets. In addition, the Company has developed relationships with financial partners who provide access to cost-competitive pools of capital.

Focused Business Development

Terasen creates value through the development of new infrastructure projects and system expansions. Utilizing our existing assets and core competencies, we develop and construct new infrastructure projects in both the gas and petroleum businesses. Value is also created through selective acquisitions, where the Company achieves cost or revenue enhancement through integration with existing operations. The Company also creates value by growing the non-regulated businesses that have been developed from Terasen's core competencies of safe, efficient and reliable operation of distribution systems.

CORE BUSINESSES

Natural Gas Distribution

Terasen's natural gas distribution operations consist primarily of Terasen Gas and TGVI in addition to several small related utility operations. Terasen Gas is the largest distributor of natural gas in British Columbia, serving more than 780,000 customers in more than 100 communities. Major areas served by Terasen Gas are Greater Vancouver, the Fraser Valley and the Thompson, Okanagan, Kootenay and North Central Interior regions of the province. TGVI serves almost 79,000 customers on Vancouver Island, in Whistler and the Sunshine Coast area. Terasen Gas and TGVI provide transmission and distribution services to their customers, and obtain natural gas supplies primarily on behalf of residential and commercial customers. Gas supplies are sourced mainly from northeastern British Columbia and, through Terasen's Southern Crossing Pipeline, from Alberta.

Petroleum Transportation

Terasen's petroleum transportation operations include the Trans Mountain, Corridor, Express and Platte pipelines. The Trans Mountain system transports crude oil and refined products from Edmonton, Alberta to Burnaby, British Columbia and also delivers Canadian crude oil to several refineries in Washington State. Trans Mountain also owns the Westridge Marine Terminal, which is located at tidewater in the Port of Vancouver, and a jet fuel pipeline to a storage system at Vancouver International Airport. Corridor owns a dual pipeline system which transports diluted bitumen and diluent between the Muskeg River mine near Fort McMurray and the Shell upgrader north of Edmonton, Alberta. Corridor commenced commercial operations in May 2003. Terasen also owns a one-third interest in the Express System which transports crude oil from Hardisty, Alberta to the Rocky Mountain region of the United States and on to Wood River, Illinois. Terasen Pipelines is the operating company that provides management and operational services to Trans Mountain, Corridor and the Express System.

Other Activities

The Other Activities segment includes non-regulated energy and utility businesses as well as corporate financing costs and administration charges. Terasen owns 100 per cent of Terasen Utility Services Inc., which owns and operates water and multi-utility distribution systems, Terasen Waterworks (Supply) Inc., which sells products related to the water, wastewater and irrigation industries, and Terasen International Inc., which is engaged in international consulting. Terasen also owns 44.2% of Clean Energy, a natural gas vehicle fuel provider, and 30% of CustomerWorks LP, a provider of utility customer care services.

STRATEGY

Terasen's core competencies are in the management and operation of infrastructure assets, in particular transmission and distribution utilities and petroleum pipelines. Our strategy is designed to take advantage of these competencies.

Natural Gas Transmission and Distribution

The Company continues to grow its natural gas transportation infrastructure in British Columbia to service its expanding customer base. In addition, Terasen derives value from its natural gas transmission and distribution assets. Through programs and activities designed to deliver operational excellence together with incentivized regulatory arrangements. The competencies applicable to natural gas distribution are also applicable to electricity and water distribution. The Company's long-term objective is to capitalize on the synergies available by combining natural gas, electricity and water distribution assets into multi-utility operations.

Petroleum Transportation

The continued development of the Alberta oil sands has become a focal point for the Company's petroleum transportation business as it continues to develop solutions for shippers' transportation needs. The expected growth of bitumen and synthetic crude oil production will require additional pipeline capacity, both to move production to the pipeline hubs in Alberta, and to move production from Alberta to downstream markets in Western Canada, the United States and offshore. Initiatives in support of this strategy include expansion of the Trans Mountain pipeline and the Express System and future development of the Bison Pipeline. The outcome of the recent open season on Express served to validate our belief in the growth opportunities arising from recent development of the Alberta oil sands and the resulting demand for pipeline capacity by shippers. The value of existing pipeline assets is also being enhanced through incentive regulation and strategies to deliver safe, cost-effective operations.

Other Activities

In support of its multi-utility strategy, Terasen pursues opportunities that arise to own and/or operate multi-utility distribution assets or provide services to other utilities. Terasen Utility Services provides a range of utility services, including gas, electricity, propane, water and wastewater management, to such resort communities as Silver Star, Panorama, Sun Peaks and Sun Rivers.

KEY PERFORMANCE DRIVERS

Key performance drivers — those factors which are critical to successful execution of the Company's strategic plan — include:

- Appropriate regulatory arrangements
- Appropriate risk management and governance processes
- Safe, efficient asset management processes
- Focused business development activities
- Ready access to capital markets

Regulatory Arrangements

Businesses which are regulated in various forms represented 97% of Terasen's asset base at December 31, 2003. Accordingly, it is essential that Terasen maintain good relationships with its various regulators and customer representatives. Appropriate and incentivized regulatory arrangements provide Terasen's regulated businesses with an incentive to manage costs and service quality, resulting in a sharing of benefits between customers and shareholders.

The construction of the Southern Crossing and Corridor pipelines on-time and on-budget demonstrate Terasen's project management skills.

Regulation — Terasen Gas

Terasen Gas is regulated by the BCUC, which approves rates for services and issues certificates for the construction of major facilities. Traditionally, rates have been set using the cost of service approach to utility regulation. Since 1996, however, incentive-based regulation has been used in the rate-setting process in order to enhance value to customers and provide opportunities for enhanced returns to shareholders.

Terasen Gas' rates are based on estimates of a number of items, such as natural gas sales volumes, cost of natural gas and interest rates. In order to manage the risks associated with some of these estimates, a number of regulatory deferral accounts are in place.

The two most significant deferral accounts relate to the risks of use per customer (the Revenue Stabilization Adjustment Mechanism, or "RSAM") and the cost of natural gas (the Gas Cost Reconciliation Account, or "GCRA"). Use per customer typically changes as a result of warmer or colder weather, or in response to changes in the price of natural gas. The cost of natural gas purchased by Terasen on behalf of its customers varies with changes in market prices for the commodity. The effect of these changes are deferred in the appropriate accounts and reflected in customer rates through regular rate-setting adjustments. The recovery of balances in the RSAM and GCRA accounts requires the prior approval of the BCUC.

The RSAM and GCRA accounts reduce Terasen's earnings exposure to related risks by deferring any variances between projected and actual gas consumption and gas costs, and refunding or recovering those variances in rates in subsequent periods. Variances in usage by large volume, industrial transportation and sales customers are not covered by these deferral accounts as their usage is more predictable and less likely to be significantly affected by weather.

Due to the recovery of balances in the RSAM and GCRA accounts in rates in 2003, the amount recoverable from customers under these deferral accounts decreased to $38.5 million as at December 31, 2003 from $76.7 million as at December 31, 2002. The remaining balance of the deferral accounts is principally attributable to the RSAM.

In order to ensure that any balances in the GCRA account are recovered on a timely basis, Terasen prepares quarterly calculations to determine whether customer rate adjustments are needed to reflect prevailing market prices for natural gas costs.

Short-term and long-term interest rate deferral accounts have also been in place to absorb interest rate fluctuations. The interest rate deferral accounts which were in place during 2003 effectively fixed the interest expense on short-term funds attributable to Terasen's regulated assets at 4.0% during 2003. The effective fixed short-term interest rate for 2004 has been set at 3.25%.

For the 2004–2007 negotiated settlement, new deferral accounts have been established for insurance premiums and pension costs incurred by Terasen Gas. These deferral accounts had not been included in previous regulatory settlements.

Allowed Rate of Return on Equity (ROE)

Terasen Gas' allowed ROE is determined annually based on a formula that applies a risk premium to a forecast of long-term Government of Canada bond yields. For 2004, the application of the ROE formula set Terasen Gas' allowed ROE at 9.15%,

down from 9.42% in 2003. The ROE reduction reflects lower forecasted long-term bond yields for 2004, compared to those used in the 2003 ROE calculation.

2002 and 2003 Revenue Requirement Applications

During 2001, a 2002 Revenue Requirement Application was filed with the BCUC as the first step in developing a renewed incentive regulatory arrangement. Because of the acquisition of TGVI and the ongoing development of a provincial energy policy, Terasen Gas, with the support of a number of customer representatives, withdrew its 2002 Revenue Requirement Application. As a result of the withdrawal, Terasen Gas' distribution rates remained at 2001 levels during 2002, and the RSAM and GCRA deferral accounts remained in effect.

In June 2002, Terasen Gas filed a 2003 Revenue Requirement Application. A public hearing on the 2003 Application was held in November 2002, and the BCUC issued its decision on February 4, 2003. The decision established revenue requirements for 2003, which set 2003 rates and formed the basis for negotiations on a new multi-year incentive regulatory arrangement.

2004–2007 Performance-Based Rate Plan

In July 2003, Terasen Gas received BCUC approval of a negotiated settlement of a 2004-2007 Performance-Based Rate Plan (PBR Settlement). The PBR Settlement establishes a process for determining Terasen Gas' delivery charges and incentive mechanisms. The four-year agreement includes incentives for Terasen Gas to operate more efficiently through sharing of the benefits of cost restructuring between Terasen Gas and its customers. The agreement includes 10 service quality measures designed to ensure Terasen Gas maintains service levels and sets out the requirements for an annual review process which will provide a forum for discussion between Terasen Gas and interested parties regarding its current performance and future activities.

Operation and maintenance costs and base capital expenditures are subject to an incentive formula reflecting increasing costs due to customer growth and inflation, less a productivity factor based on 50 per cent of inflation during the first two years and 66 per cent of inflation during the last two years. Base capital expenditure amounts are a function of customer numbers and projected customer additions. The PBR settlement provides for a 50/50 sharing mechanism of earnings above or below the allowed return on equity beginning in 2004. Because a PBR arrangement was not in place during 2003, efficiencies achieved during 2003 were not subject to sharing with customers.

Natural Gas Commodity Unbundling

Over the past several years, Terasen Gas, the BCUC and a number of interested parties have been exploring options to provide increased customer choice to residential and smaller commercial users for their natural gas commodity purchases. Currently, these customers can only purchase their natural gas supplies from Terasen Gas. Terasen Gas is working with stakeholders to ensure that commodity unbundling and customer choice proceeds in a manner that adds value for customers without exposing Terasen Gas and its customers to undue risk. The Company does not anticipate that the introduction of these arrangements will have a material impact on the Company's financial results.

Regulation — TGVI

TGVI is also regulated by the BCUC. In 1995, an agreement was entered into between TGVI, the Province of British Columbia (the Province) and the Government of Canada, which included a Special Direction that was issued to the BCUC. The agreement, which expires no sooner than 2011, includes the following terms:

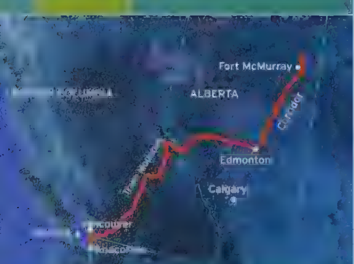
- Certain customers were charged rates that were lower than TGVI's full cost of service, based on a discount to the prices of electricity and oil. These preferential rates ended on December 31, 2002. Other customers were charged rates that escalated for inflation and reflected current natural gas costs, but remained somewhat lower than the full cost of service. These rates also ended on December 31, 2002.

- TGVI receives, for the benefit of its customers, an annual payment until 2011 from the Province based on the wellhead price of natural gas in B.C. This payment amounted to $34.1 million in 2003.

- The accumulated revenue deficiency resulting from overall revenues being below the cost of service has been recorded in a Revenue Deficiency Deferral Account (RDDA). When Terasen acquired TGVI, the amount of the RDDA was $85 million, for which Terasen paid a price of $61 million. The accumulated RDDA recorded on Terasen's consolidated financial statements totaled $56.4 million as at December 31, 2003, corresponding to a balance for TGVI regulatory purposes of $75.3 million, down $12.6 million from December 31, 2002. Terasen is committed to fund these revenue deficiencies by purchasing preferred shares or subordinated debt issued by TGVI. The BCUC was directed to set rates beginning in 2003 that amortize the RDDA balance over the shortest period reasonably possible, having regard for TGVI's competitive position relative to alternative energy sources and the desirability of reasonable rates. The earnings impact of the RDDA discount is discussed under Results — Natural Gas Distribution.

- Any variances in the achieved ROE in a particular year from the allowed ROE (other than variances resulting from operation and maintenance costs) are deferred and recorded in the RDDA. As a result, most risks associated with TGVI's annual financial results (other than operating costs) are, subject to BCUC approval, transferred to customers through the RDDA.

TGVI's three-year regulatory settlement took effect January 1, 2003. It provides for a continuation of the operation and maintenance cost incentive arrangements previously in place, and increases the allowed ROE for TGVI to a rate that is 0.50% higher than the allowed ROE for Terasen Gas, which equates to 9.65% for 2004. TGVI's allowed ROE in 2003 was 9.92%.



Trans Mountain Pipeline

Trans Mountain is the only pipeline providing Alberta petroleum producers with access to the West Coast of North America.

Regulation — Trans Mountain

The National Energy Board (the "NEB") regulates the Canadian portion of Trans Mountain's crude oil and refined products pipeline system. The NEB authorizes pipeline construction and establishes tolls and conditions of service. Prior to 1996, tolls were set using a traditional cost of service methodology.

In November 2000, Trans Mountain and shipper representatives reached a negotiated agreement to determine Trans Mountain's tolls for the period 2001–2005. This Incentive Toll Settlement ("ITS") was approved by the NEB on March 22, 2001 to take effect as of January 1, 2001.

The 2001–2005 ITS establishes base tolls on Trans Mountain's Canadian mainline for the term of the settlement as long as throughput remains within a band of approximately 179,000 to 201,000 bbl/day. Tolls are set using a base through put level of approximately 189,000 bbl/day. Any revenue shortfalls arising from annual throughput levels below 179,000 bbl/day are recovered from the shippers. Incremental revenues arising from annual throughput above 201,000 bbl/day are shared 50/50 between Trans Mountain and the shippers. The base tolls do not escalate with inflation

unless Canadian inflation rates increase above 3.5%. Trans Mountain keeps all of the benefits achieved through productivity initiatives and operating efficiencies.

The 2001–2005 ITS also provides for two incentive tolls which can provide toll reductions for specified types of shipments on Trans Mountain's pipeline system. The incentive tolls apply to movements of an alkylate material which replaced methyl tertiary butyl ether ("MTBE") and can be applied to export volumes of oil loaded over the Westridge Dock in Vancouver Harbour. The toll reduction applicable to movements over the Westridge Dock was removed in 2003 due to high volumes but can be re-instated if market conditions dictate.

The toll charged for the U.S. portion of Trans Mountain's pipeline in Washington State falls under the jurisdiction of the Federal Energy Regulatory Commission ("FERC"). Regulation by FERC is on a complaint basis. There were no complaints in 2003.

Regulation – Corridor

As an intra-provincial pipeline system, Corridor is subject to the jurisdiction of the Alberta Energy and Utilities Board (the AEUB). With respect to Corridor, matters such as rates of return, construction and operation of facilities, and tolls are governed by contractual arrangements with shippers.

The Firm Service Agreement (FSA) between Corridor and its shippers sets pipeline tolls based on conventional cost of service mechanisms. The FSA is a 25-year agreement, with return on equity linked to prevailing long Canada bond yields. Shell Canada Limited, Chevron Canada Resources Limited and Western Oil Sands Inc. have entered into long-term ship-or-pay contracts with Corridor for 60%, 20% and 20%, respectively, of the available capacity on the Corridor Pipeline.

Regulation – Express System

The Canadian segment of the Express Pipeline is regulated by the NEB, with tolls being regulated on a complaint basis only. The Platte Pipeline and the U.S. segment of the Express Pipeline are regulated by FERC, with tolls also being regulated on a complaint basis. The Wyoming Public Service Commission (the "WPSC") regulates the transportation of petroleum on the Platte Pipeline within the State of Wyoming. The WPSC standards applicable to tolls are similar to those of the FERC and the NEB.

In November and December 2003, Terasen conducted an open season to obtain long-term commitments for a portion of its current uncommitted capacity and for expansion capacity, the latter available in April 2005. The results of the open season were very positive and based upon current capacity of 172,000 bpd, Express will have 85% committed through long-term contracts. Post-expansion, Express will have 79% of the 280,000 bpd total capacity contracted. These contracts expire in 2007, 2012, 2014 and 2015 in amounts of 1%, 40%, 11% and 27% of total capacity, respectively. These contracts provide for committed tolls for transportation on the Express System, which can be increased each year by up to 2%. The remaining capacity is made available to shippers as uncommitted capacity.

FERC regulations set ceiling tolls that can be charged for uncommitted capacity. The tolls for uncommitted capacity on the Express System are currently lower than the FERC ceiling tolls, as they have been set at levels that maintain the Express System's competitiveness relative to alternative pipelines. Tolls for movements of U.S. domestic grades on the Platte Pipeline are also currently set at less than ceiling tolls.

Risk Management and Governance

In order to ensure that operating and financial results meet customer, regulatory and shareholder expectations, an effective system of risk management and governance is essential. Terasen has implemented an Enterprise Risk Management framework and a risk management process across the organization to ensure that significant business risks are identified, evaluated and appropriately managed and monitored. Terasen's corporate governance practices are described more fully in Terasen's management proxy circular in connection with the 2004 annual shareholders meeting.

Asset Management

The focus of asset management is to ensure reliable, cost effective, quality service with full regard for the safety of employees and the public while operating in an environmentally responsible manner. Appropriate regulatory arrangements provide incentives to manage costs and maintain or improve service quality. Once opportunities are available, asset management skills are key to capitalizing on these incentives.

Through the terms of its regulatory settlements, Terasen Gas has been successful in achieving and exceeding its productivity targets and capitalizing on incentives. An independent analysis of operating costs found that Terasen Gas was the best performer among ten Canadian gas distribution utilities on the measures of customers per employee and operating costs per customer. Terasen's petroleum transportation business has also taken steps to reduce operating costs under Trans Mountain's Incentive Toll Settlement.

In order to sustain incentivized regulatory arrangements, cost management must be paired with consistent and/or improving service quality. In January 2003, Terasen Gas implemented a new Order Fulfillment System to streamline the natural gas connection process for builders, developers and mechanical contractors. In the 2004–2007 PBR settlement, 10 service quality measures were established to ensure Terasen Gas maintains appropriate levels.

Safety and environmental management is a key aspect of effective asset management. Terasen Gas has established programs to use resources more efficiently and effectively including a greenhouse gas management program, industrial waste recycling and salvage shop operations. For the fifth year in a row, Terasen Gas was awarded gold level reporting status from Canada's Climate Change Voluntary Challenge and Registry.

Terasen has detailed emergency preparedness plans in place to respond to natural disasters, accidents and emergencies, and regularly tests these plans in simulations involving employees and other emergency response organizations. The Company is also committed to monitor and assess its safety and environmental performance regularly. The Company incorporates safety performance measures into its employee compensation system, sets targets and objectives for environmental performance and conducts safety and environmental audits.

The natural gas distribution and petroleum transportation businesses maintain comprehensive facility risk assessment and pipeline integrity management programs as preventive measures to mitigate the risk of a pipeline failure or other loss of system integrity. These programs are intended to reduce both the likelihood and severity of the business interruption and/or environmental liability that could result from a pipeline failure or loss of integrity.

Business and Project Development

Terasen's success in business and project development is expected to come through

a combination of greenfield expansions of existing assets and accretive acquisitions of complementary assets.

Early in 2004, Terasen made significant changes to its senior management team, which will serve to strengthen its expertise in the area of business and project development. Gordon Barefoot, who had previously held the position of Senior Vice President, Corporate Development and Senior Vice President, Multi-Utility, was named Senior Vice President, Finance and Chief Financial Officer. To fill the role of Senior Vice President, Corporate Development, the Company hired Stephen Swaffield. Mr. Swaffield has extensive experience in the areas of investment banking, gas utilities and oil and gas pipelining. The changes have enhanced the Company's expertise in the area of business and project development, and resulted in a much tighter link between its financial operations and corporate development.

The risks associated with new construction projects require that the Company retain strong project management capabilities. The construction of the Southern Crossing and Corridor pipelines on time and on budget have demonstrated the quality of Terasen's project management skills, which will continue to be applied to new infrastructure construction opportunities. A key aspect of construction project management for Terasen is ensuring that contractors are responsible and accountable for risks that they can best manage.

In the end, the ability to successfully integrate new acquisitions into Terasen's existing asset base will have a significant impact on the Company's ability to create value through the acquisition of complementary infrastructure assets and related businesses.

Access to Capital

In order to meet the capital investment and return requirements of its businesses, Terasen must have reliable access to cost competitive capital. The Company's requirements for capital and access to capital are discussed more fully under Liquidity and Capital Resources.

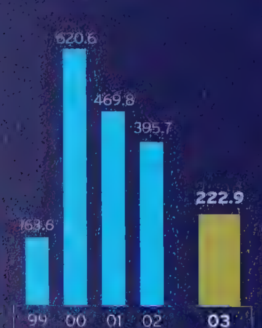
The development of income-oriented investment vehicles, such as income trusts, has created tax advantaged cost of capital for certain investors and increased the prices that can be paid for acquisitions of certain infrastructure assets. In some circumstances, a corporate financing structure such as Terasen's stand-alone structure is unable to achieve a cost of capital that is as low as these alternative structures. In order to remain competitive in the pursuit of certain acquisitions, it may be necessary for Terasen to develop alternative structures that deliver a lower cost of capital or make the size of a transaction more manageable from a risk management perspective.

An example of such an alternative structure is the consortium formed by Terasen to acquire the Express System. Terasen and two major Canadian pension funds each own an equal interest in the Express System. The structure developed by Terasen results in a pairing of the pension funds' financial capabilities with Terasen's operating capabilities, while delivering attractive overall returns to Terasen on its investment.

In November 2003, the B.C. provincial government repealed the BC Hydro and Power Authority Privatization Act, removing director residency requirements and share ownership restrictions on Terasen's common shares. Subsequent to repeal of the Act, Terasen implemented a Shareholder Rights Protection Plan, similar to those adopted by other publicly traded companies. These changes will allow greater flexibility in financing future acquisitions.

Growth in the Alberta oil sands in 2003 increased demand for petroleum transportation.

Terasen Inc.
Consolidated Capital Expenditures
$ Millions



Capital expenditures are expected to decline following the completion of the Corridor pipeline and lower base capital expenditures.

FINANCIAL AND CAPITAL MANAGEMENT

LIQUIDITY AND CAPITAL RESOURCES

Consolidated Cash Flow

Cash from operations refers to cash generated before the impact of working capital and deferral account changes. The increase in cash from operations was primarily a result of higher earnings during the year. During 2003, Terasen's cash from operations increased to $292.3 million from $244.0 million in 2002, primarily due to contributions from Corridor and Express. Cash flow from operating activities, which includes the impact of changes in working capital and deferral accounts, declined to $269.8 million in 2003 from $318.1 million in 2002. The cash flow from operating activities during 2003 was impacted by an increase in non-cash working capital, which was a result of higher accounts receivable and inventory levels relating to higher gas prices.

Capital Expenditures

Capital expenditures totaled $222.9 million in 2003 compared with $395.7 million in 2002. The primary reason for the decline in capital spending was the completion of the Corridor pipeline project in early 2003.

Actual capital spending in 2003 and forecast capital spending in 2004 is summarized as follows:

Capital Expenditures

In millions of dollars	**2003 Actual**	2004 Forcast
Natural gas distribution		
Terasen Gas	**$ 116.2**	$ 103.1
TGVI	**18.9**	22.8
	135.1	125.9
Petroleum transportation		
Trans Mountain	**26.8**	35.8
Corridor	**50.4**	0.2
	77.2	36.0
Other activities	**10.6**	24.1
Total	**$ 222.9**	$ 186.0

Projected Capital Expenditures

Terasen has estimated total 2004 consolidated capital expenditures of $186.0 million. Capital expenditures are expected to decline $36.9 million from 2003 levels as a result of the completion of the Corridor pipeline and lower base capital expenditures at Terasen Gas. The decline in capital expenditures will be partially offset by planned expenditures for the water and utility services business. The Company expects to finance capital expenditures with a combination of long-term debt, short-term borrowings and internally generated funds. Trans Mountain capital expenditures include $16 million related to capacity expansion.

Coverage Ratios

Due to the capital intensive nature of the Company's businesses and the need to raise debt frequently in the fixed income market, maintenance of its financial ratios is a priority for Terasen. The most significant ratios are considered to be interest coverage and debt as a percentage of total capital. These are presented below on a consolidated basis for Terasen and Terasen Gas.

Financial Ratios	2003	2002
Interest Coverage		
Terasen Inc.	**2.1**	2.1
Terasen Gas	**2.0**	2.0
Debt To Total Capital (as at December 31)		
Terasen Inc.	**67%**	66%
Terasen Gas	**68%**	68%

Interest coverage for Terasen improved in 2003 compared to 2002 mainly as a result of higher earnings. Terasen's target debt level as a percentage of total capital continues to be 67%. Interest coverage is targeted to be at or above 2.0 for Terasen Inc. and Terasen Gas.

Public Issues

In May 2003, Terasen issued $100 million of medium term note debentures at an interest rate of 4.85%. In September 2003, Terasen Gas issued $150 million of medium term note debentures at a floating interest rate. There were no new debenture issues in 2002.

There were no new equity issues completed in 2003. In March 2002, 5,208,000 Subscription Receipts which had been issued in November 2001 for gross proceeds of $188.3 million were converted into an equal number of common shares of Terasen. In addition, a total of 7,931,600 common shares were issued in December 2002 in concurrent public and private placements for gross proceeds of $301.4 million.

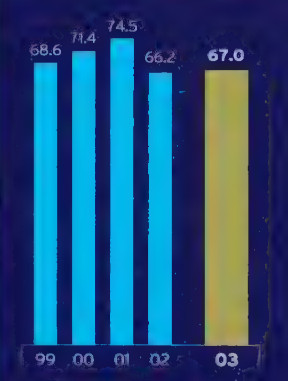
Lines of Credit

As at December 31, 2003, the Company had lines of credit in place totaling $1,559 million to finance cash requirements, comprising $200 million at Terasen, $500 million at Terasen Gas, $224 million at TGVI, $110 million at Trans Mountain and $525 million at Corridor. These lines enable the respective companies to borrow directly from their bankers, issue bankers' acceptances and support commercial paper issued by each Company. Bank lines of $321 million were unutilized at the end of 2003. Virtually all short-term cash needs are funded through commercial paper and bankers' acceptances in the Canadian market at rates generally below bank prime.

Credit Ratings

Securities issued by Terasen, Terasen Gas, Trans Mountain and Corridor are rated by DBRS Inc. (DBRS), Moody's Investors Service Inc. (Moody's) and Standard & Poor's, a division of The McGraw-Hill Companies (S&P). The ratings assigned to securities issued by the Terasen group of companies are reviewed by these agencies on an ongoing basis.

Terasen Inc.
Debt to Total Capital
Percent



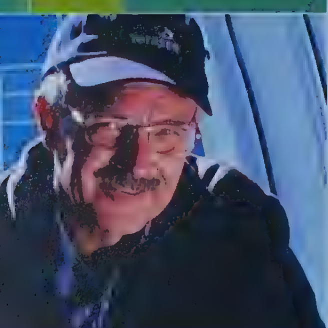
Terasen is within its targeted capital structure of 67 per cent debt and 33 per cent equity.

The table below summarizes the ratings assigned to the Company's various securities at December 31, 2003.

Credit Ratings	DBRS	Moody's	S&P
Terasen Inc.			
Commercial paper	R-1 (Low)		A2
Unsecured long-term debt	A (Low)	A3	BBB-
Capital securities	BBB (High)	Baa1	BB+
Terasen Gas Inc.			
Commercial paper	R-1 (Low)		A2
Unsecured long-term debt	A	A2	BBB
Secured long-term debt	A	A1	BBB
Terasen Pipelines (Trans Mountain) Inc.			
Commercial paper	R-1 (Low)		A2
Unsecured long-term debt	A (Low)		BBB+
Terasen Pipelines (Corridor) Inc.			
Commercial paper	R-1 (Low)		A2

In November, 2002, S&P and Moody's placed Terasen's credit ratings on Credit Watch with negative implications and Under Review with negative implications, respectively. Moody's reaffirmed Terasen's credit ratings in January 2003. In June 2003, S&P lowered Terasen Inc.'s long-term corporate credit rating from BBB+ to BBB, following a review of Canadian utility regulation. At the same time, S&P removed the negative Credit Watch and affirmed a stable outlook. Similar actions were taken on the long-term credit ratings of Terasen Gas and Trans Mountain. The rating change did not have a material impact on Terasen's borrowing rate or capacity to access the capital markets.

After reassessing its relationship with S&P, Terasen decided early in 2004 to discontinue S&P's engagement to provide credit ratings on Terasen debt. Terasen believes the credit ratings issued by Moody's and DBRS will be sufficient to service the requirements of creditors and maintain the Company's access to capital.



Safe, efficient and reliable operations are key to maintaining incentive-based regulatory arrangements.

Off-Balance Sheet Arrangements

In 2000, Terasen Gas entered into a leasing arrangement to finance new building facilities in the Greater Vancouver area. The Coastal Facilities synthetic lease agreement is currently accounted for as an off-balance sheet item. As at December 31, 2003, the value of the Coastal Facilities leasing agreement was approximately $50 million. The lease agreement expires in November 2007.

HUMAN RESOURCES

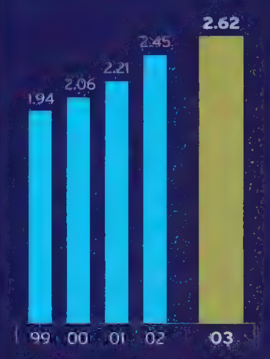
Collective Agreements

Terasen Gas has long-term agreements in place with the Office and Professional Employees International Union (OPEIU) and the International Brotherhood of Electrical Workers (IBEW), which expire on March 31, 2007 and March 31, 2006, respectively. TGVI has two collective agreements in place, neither of which are intended to be renewed. The Company is in discussions with the IBEW regarding the integration of TGVI's collective agreements into the Terasen Gas IBEW and OPEIU collective agreement. The discussions are proceeding and a new agreement is expected to be reached in 2004.

Succession Planning

Terasen has in place a succession planning process which covers approximately 40 senior or key positions and includes an assessment of strengths and gaps in the various organizational units, and the identification of potential successors for key positions and high potential candidates for longer-term development. In 2003, the Company continued to expand and enhance its succession planning process, which served us well in decisions related to the restructuring and integration of Terasen Gas and TGVI. Throughout the year a number of high potential individuals participated in a new focused leadership development program. This is intended to be part of our ongoing succession process which is updated and enhanced each year.

Terasen Inc.
Earnings Per Share
(Before Non-Recurring Items)
Dollars



Earnings per share before non-recurring items were $2.62 in 2003, up 6.9 per cent from 2002.

FINANCIAL RESULTS

EARNINGS PERFORMANCE

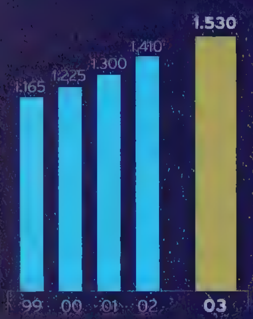
The contribution to earnings applicable to common shares of each segment is as follows:

Years ended December 31	**2003**		2002	
In millions of dollars except per share amounts		**Per Share**		Per Share
Natural gas distribution				
Terasen Gas	**$ 72.6**	**$ 1.40**	$ 69.5	$ 1.61
TGVI	**26.2**	**0.50**	22.9	0.53
	98.8	**1.90**	92.4	2.14
Petroleum transportation				
Trans Mountain	**35.8**	**0.69**	29.3	0.68
Corridor	**10.7**	**0.21**	—	—
Express System	**9.7**	**0.18**	—	—
	56.2	**1.08**	29.3	0.68
Other activities	**(18.9)**	**(0.36)**	(15.9)	(0.37)
Earnings before non-recurring items	**136.1**	**2.62**	105.8	2.45
Non-recurring items	**(3.4)**	**(0.06)**	—	—
Earnings applicable to common shares	**$ 132.7**	**$ 2.56**	$ 105.8	$ 2.45

Terasen discloses earnings before non-recurring items in order to assist investors in evaluating which components of the Company's earnings are likely to be sustainable in future years. For this purpose, the Company identifies non-recurring items, which are material gains and losses that, in management's opinion, arise from events or circumstances that are not expected to occur on a regular basis. Earnings before non-recurring items does not have any standardized meaning prescribed by generally accepted accounting principles, and therefore may not be comparable to similar measures presented by other Canadian issuers of securities. In 2003, Terasen incurred a non-recurring restructuring charge of $3.4 million after-tax related to the integration of Terasen Gas and TGVI. There were no material non-recurring items in 2002.

According to segmented reporting, Terasen's share of earnings from the Express System is recorded as $9.7 million. On the Statement of Earnings, Express's contribution to earnings is recorded as $8.0 million. The difference is related to tax benefits that are realized by Terasen outside of the Express partnership.

Terasen Inc.
Dividends Paid Per Share
Dollars



Over the past five years, Terasen's dividend per share has grown at an annualized rate of seven per cent.

Natural Gas Distribution
Customer Additions

Net customer additions in 2003 were 8,484 bringing the total number of utility customers to 859,183 at year-end.

Earnings applicable to common shares were $132.7 million in 2003 compared to $105.8 million in 2002. An analysis of the increase in earnings is as follows:

In millions of dollars	
Earnings applicable to common shares for 2002	$ 105.8
Natural Gas Distribution	
Increase in RDDA discount accretion	2.5
Lower income tax rates and other items	3.9
Petroleum Transportation	
Earnings from the acquisition of the Express system (before foreign exchange loss)	13.3
Express foreign exchange loss	(3.6)
Earnings from the Corridor pipeline	10.7
Higher throughput and other items	6.5
Other Activities	
Higher corporate expenses, financing costs, and other items	(5.3)
Lower write-down of investment in Westport Innovations Inc.	2.3
Earnings before non-recurring items	136.1
Non-recurring items	(3.4)
Earnings applicable to common shares for 2003	$ 132.7

In the fourth quarter of 2003, earnings before non-recurring items were $62.1 million, as compared with $56.0 million in the fourth quarter of 2002. The increase in earnings in the fourth quarter was driven mainly by the contributions from Express and Corridor, which were not present in 2002.

FINANCIAL OBJECTIVES

Terasen's primary financial objectives are to provide shareholders with consistent and growing dividends and to reinvest earnings not paid out as dividends at rates of return that will deliver annual earnings per share growth of 6% or more on a consistent basis. During 2003, dividends paid per common share were $1.53 per share, up 8.5% from $1.41 per share in 2002. Earnings per share before non-recurring items grew 6.9%, from $2.45 in 2002 to $2.62 in 2003. Over the past five years, dividends per share and earnings per share before non-recurring items have grown at compound annual rates of 7.0% and 7.2%, respectively.

Natural Gas Distribution

In millions of dollars	**2003**	2002
Revenues	**$ 1,497.9**	$ 1,402.7
Operating expenses		
Cost of natural gas	**889.7**	807.2
Operation and maintenance	**189.4**	179.3
Depreciation and amortization	**92.5**	92.6
Property and other taxes	**48.6**	46.9
	1,220.2	1,126.0
Operating income	**277.7**	276.7
Financing costs	**135.5**	136.8
Earnings before income taxes	**$ 142.2**	$ 139.9

Revenues from natural gas distribution increased to $1,497.9 million during 2003 from $1,402.7 million in 2002. Revenues are set at levels designed to recover the cost of delivery service of Terasen Gas and TGVI, together with the cost of the natural gas commodity. Revenues in 2003 were higher primarily as a result of the higher cost of natural gas.

TGVI's RDDA generates earnings from the return on the instruments used to finance the RDDA, as well as amortization of the difference between the actual value and the purchase price of the RDDA at the time TGVI was acquired by Terasen. These earnings are determined by applying an accretion rate to the discounted value of the RDDA recorded on Terasen's financial statements. During 2003, the accretion rate on the RDDA balance was increased to 13.4% from 10.2% to recognize faster forecast recovery of the RDDA. As a result, earnings arising from the RDDA balance increased to $8.7 million in 2003 from $6.2 million in 2002. RDDA earnings are expected to decline to $7.6 million in 2004 as a result of a lower year-end RDDA balance in 2003.

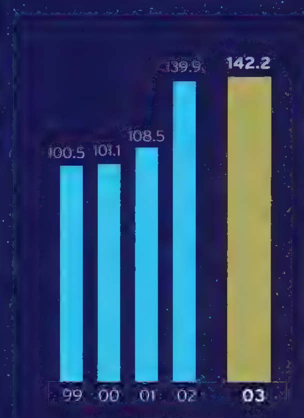
Terasen Gas and TGVI net customer additions during 2003 were 5,822 and 2,662, respectively, bringing the total number of utility customers to 859,183 at year-end. The total increase of 8,484 customers was down from the 9,601 net customer additions recorded in 2002. The pace of net new additions slowed in part due to multi-family dwellings, which are an increasing share of new housing starts in British Columbia and have a lower natural gas penetration than single-family dwellings.

Terasen Gas industrial sales volumes decreased by 1,756 terajoules while transportation volumes declined by 4,425 terajoules from the previous year. Terasen Gas earns approximately the same margin regardless of whether a customer contracts for sales or transportation service. The decrease in industrial volumes reflected lower interior bypass volumes and reduced west to east backhaul volumes on Southern Crossing, neither of which have a material impact on the margin.

Higher natural gas prices resulted in the cost of natural gas increasing to $889.7 million in 2003 from $807.2 million in 2002.

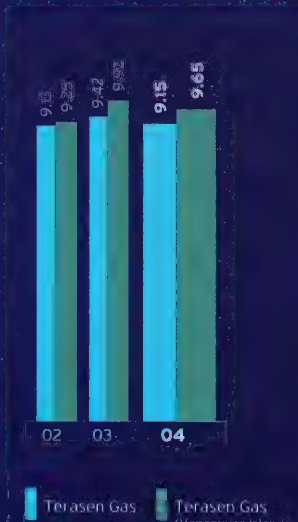
Operating and maintenance expenses increased to $189.4 million in 2003 from $179.3 million in 2002. The increase in expenses is primarily attributable to a $5.2 million

Natural Gas Distribution Earnings Before Income Taxes
$ Millions



Earnings in 2003 increased as a result of improved operating results and a lower income tax expense.

Natural Gas Distribution Allowed Return on Equity
Percent

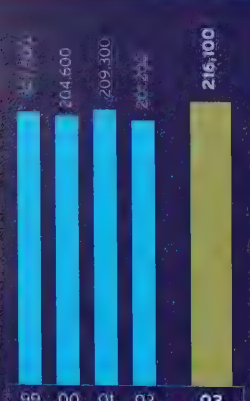


Allowed returns in 2004 decreased due to lower bond yields.

Petroleum Transportation Earnings Before Income Taxes
$ Millions

Earnings before income taxes increased in 2003 as a result of higher throughput on Trans Mountain, the acquisition of a one-third interest in Express and the commencement of commercial operations on Corridor.

Petroleum Transportation Trans Mountain Canadian Mainline Throughput
Barrels per day



Strong growth in petroleum deliveries on the Canadian and U.S. mainline drove revenue and earnings growth from Trans Mountain.

pre-tax restructuring charge associated with the operational integration of Terasen Gas and TGVI, and a higher number of billable customers in 2003.

Financing costs declined to $135.5 million in 2003 from $136.8 million in the previous year. The decline was mainly a result of the refinancing of higher-cost long-term debt that matured during the year.

Earnings from natural gas distribution increased to $52.6 million in the fourth quarter of 2003, from $50.0 million in the fourth quarter of 2002. The increase in earnings during the quarter was attributable to improved operating results and a lower tax expense.

Petroleum Transportation

In millions of dollars	**2003**	2002
Revenues	**$ 200.0**	$ 136.0
Operating expenses		
Operation and maintenance	**57.0**	43.8
Depreciation and amortization	**30.0**	17.1
Property and other taxes	**21.0**	18.7
	108.0	79.6
Operating income	**92.0**	56.4
Financing costs	**23.2**	9.5
Earnings before contribution from Express and income taxes	**68.8**	46.9
Share of earnings of Express System	**8.0**	—
Earnings before income taxes	**$ 76.8**	$ 46.9

Revenues from petroleum transportation operations increased to $200.0 million in 2003 from $136.0 million in 2002. The increase was due mainly to the addition of the Corridor pipeline and increased throughput on the Trans Mountain mainline.

Average throughput on the Trans Mountain mainline increased to 216,100 bbl/day in 2003 from 201,200 bbl/day in 2002. U.S. mainline deliveries averaged 54,600 bbl/day in 2003, compared to 47,800 bbl/day in 2002.

As discussed previously under Regulatory Arrangements, Trans Mountain's Canadian mainline is subject to a regulatory settlement that mitigates the impact on earnings of variations in throughput volumes outside a defined band. However, Trans Mountain's U.S. pipeline in Washington State is not subject to the same regulatory arrangements, and fluctuations in throughput on these pipelines will have a direct impact on petroleum transportation revenues and earnings. Fluctuations in throughput on the Express System will have a direct impact on Terasen's equity share of earnings.

Operation and maintenance expenses increased to $57.0 million in 2003 from $43.8 million in 2002. Operating efficiencies achieved during the year were offset by the inclusion of the Corridor pipeline and increased power costs related to higher throughput on the Trans Mountain mainline. In addition, Trans Mountain incurred an additional $1.5 million in power and generation costs as a result of forest fires in August 2003.

Financing costs in 2003 were $23.2 million, compared with $9.5 million in 2002. The inclusion of Corridor in the financing costs accounted for majority of the year-over-year increase.

Petroleum transportation reported earnings of $17.9 million in the fourth quarter of 2003, compared with $10.5 million in the fourth quarter of 2002. The increase in earnings from Petroleum transportation in the fourth quarter was due to the contributions of Express and Corridor, which were not present in the corresponding quarter of 2002.

Other Activities

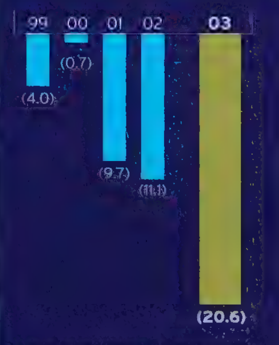
In millions of dollars	**2003**	2002
Revenues	**$ 178.7**	$ 168.5
Operating expenses		
Operation and maintenance	**67.2**	66.2
Depreciation and amortization	**10.9**	5.9
Property and other taxes	**0.3**	0.5
Cost of revenues	**103.6**	92.5
	182.0	165.1
Operating income (loss)	**(3.3)**	3.4
Financing costs	**17.3**	14.5
Loss before income taxes	**$ (20.6)**	$ (11.1)

Revenue increased to $178.7 million in 2003 from $168.5 million in 2002. The increase was attributable primarily to Terasen Utility Services. Losses from other activities in 2003 were $20.6 million before income taxes compared with a loss of $11.1 million in 2002. The increase in the loss from other activities was due mainly to higher corporate expenses and a decrease in earnings from Terasen International, which was related to the completion of the Sharjah project. Financing costs increased by $2.8 million to $17.3 million in 2003 from $14.5 million in 2002, as a result of the increase in the amount of debt outstanding.

In 2003, the Company incurred a $2.2 million pre-tax ($1.8 million after-tax) write-down on its investment in Westport Innovations Inc., reducing its carrying value to $1.69 per share, or $871,000 in aggregate. In 2002, Terasen incurred a $4.9 million before tax ($4.1 million after-tax) write-down of the Company's investment in Westport.

Losses from other activities increased to $8.4 million in the fourth quarter of 2003 from $4.5 million in the fourth quarter of 2002. Higher losses were mainly a result of the Westport write-down in 2003 and an increase in financing costs.

Other Activities Loss Before Income Taxes
$ Millions



Strong performance in Waterworks and Utility Services was offset by higher corporate expenses and financing costs.

BUSINESS DEVELOPMENT

ACQUISITION OF EXPRESS PIPELINE

On January 9, 2003 a consortium including Terasen, Borealis Infrastructure Management Inc., and Ontario Teachers' Pension Plan acquired the Express System from EnCana Corporation. The purchase price was $1,203.5 million, including assumed debt of $578.8 million. Terasen's share of the equity portion of the purchase price was $206.7 million. Each of the three consortium members owns an equal interest in the Express System. Terasen Pipelines operates the Express System on behalf of the consortium.

EXPANSION OF EXPRESS SYSTEM

During December 2003, Terasen held an open-season for current and expansion capacity on the Express System. Given the significant demand for capacity by the Shippers, Terasen, on behalf of the owners, is proceeding with both Phase I and Phase II of its expansion plans for the Express System. In total, the expansion will add 108,000 bbl/day in capacity, bringing the total capacity on the Express System to 280,000 bbl/day. Both phases of the expansion are expected to be completed by April 2005.

BISON PIPELINE PROJECT

Terasen Pipelines (Bison) Inc., a wholly-owned subsidiary of the Company, has proposed a pipeline to transport bitumen from the Athabasca oil sands to the Edmonton area. The Bison Pipeline Project is dependent on shipper's demand for transportation resources and will also require regulatory approval.

TRANS MOUNTAIN EXPANSION

In 2004, Terasen intends to complete an expansion of the Trans Mountain mainline. The expansion will add an additional 27,000 bbl/day at an estimated cost of $16 million. The in-service date for the expansion capacity is expected to be late 2004.

TMX

TMX is Terasen's proposed three-phase looping of the Trans Mountain mainline, which would ultimately result in additional capacity of 640,000 bbl/day. Incremental capacity would be added through three stages — 100,000 bbl/day in Phase I, 100,000 bbl/day in Phase II and 440,000 bbl/day in Phase III — at an estimated total cost of approximately $2 billion. TMX will require regulatory approval and is dependent on shipper's demand and support for the project.

Terasen's strategic objective for its petroleum transportation business is to leverage its expertise in conjunction with the development of the Alberta oil sands.

VANCOUVER ISLAND GAS SUPPLY

Terasen Gas is actively pursuing alternatives for the supply of additional natural gas to Vancouver Island. The Company is responding to the need for increased gas supply and, accordingly, is supporting plans for new gas-fired power generation on Vancouver Island. Terasen Gas' proposal for new natural gas capacity involves a combination of compression and pipeline looping as well the addition of a liquefied natural gas (LNG) storage facility on Vancouver Island. The expansion costs are estimated at $80 million for the additional compression and $100 million for the new LNG tank. The proposed tank would have the capacity to hold one billion cubic feet of liquefied natural gas.

MUNICIPAL LEASING TRANSACTIONS

Certain municipalities in Terasen Gas' service area have an option to purchase the gas distribution franchise within their municipal boundary. In order to address these purchase options, the Company has developed a leasing arrangement that allows Terasen Gas to continue to operate the gas distribution assets by effectively selling the assets to the municipality and leasing them back for a 17 year period. After 17 years, Terasen Gas has an option to repurchase the assets at depreciated book value. At December 31, 2003, Terasen Gas had entered into transactions involving a total value of $71.3 million. If all of the eligible municipalities execute similar transactions, the total value (including those already completed) is expected to be approximately $199 million.

CUSTOMERWORKS

Terasen owns 30% of CustomerWorks LP, a limited partnership that was created in January 2002, in partnership with Enbridge Inc. In May 2003, Accenture Business Services for Utilities (Accenture) assumed responsibility for CustomerWorks'

operations. Accenture continues to provide CustomerWorks' utility, municipal and retail energy customers with customer care, technology support and other business services. Terasen Gas has entered into a long-term contract with CustomerWorks LP for the provision of billing and customer care services.

RISK ASSESSMENT

ENVIRONMENTAL AND SAFETY

Terasen could be exposed to significant operational disruptions, environmental liability and reputational consequences in the event of a petroleum product spill, an accident involving natural gas or a compromise to water distribution systems operated and/or maintained by Terasen. Terasen believes that it has taken all reasonable and prudent steps to minimize its exposure in the case of a catastrophic event or environmental upset. The Company's efforts in this area are discussed under "Key Performance Factors — Asset Management."

The cost of abandoning pipeline systems at the eventual end of their useful lives may not be fully recovered in rates or tolls. Until such time as the magnitude of and the funding mechanism for the eventual recovery of negative salvage is determined, the Company's petroleum transportation and gas distribution businesses, like those of other Canadian pipeline systems, make no provision for these amounts.

REGULATORY TREATMENT

Through the regulatory process, the BCUC approves the return on equity which Terasen Gas and TGVI are allowed to earn, in addition to various other aspects of utility operations. Fair regulatory treatment that allows Terasen Gas and TGVI to earn a risk adjusted rate of return comparable to that available on alternative, similar investments is essential for ongoing capital attraction and growth.

The RDDA accumulated by TGVI is funded by the Company. Recovery of the deficiency through rates charged to customers is dependent upon regulatory approval and must be balanced against maintaining the competitiveness of TGVI's service relative to alternative energy sources. The Company began recovery of the deficiency in 2003.

Under the 2001–2005 incentive toll settlement, Trans Mountain is unable to incorporate most cost increases into its tolls and so bears greater risk associated with cost increases than in previous years.

The Company's pension obligations are funded by pension plan investments in a variety of assets, including equities, where investment returns may be insufficient to meet pension obligation liabilities. The majority of the Company's pension obligations relate to regulated businesses, where pension deficits are generally recoverable through the regulatory process. As part of the 2004–2007 PBR settlement for Terasen Gas a new deferral account was established for pension costs.

Terasen has in place a number of performance-based regulatory frameworks, which provide for additional returns based on operating efficiencies. There is a risk that upon expiry of existing agreements, new agreements will be subject to rebasing and may not provide the same opportunities for returns from efficiencies that exist today.

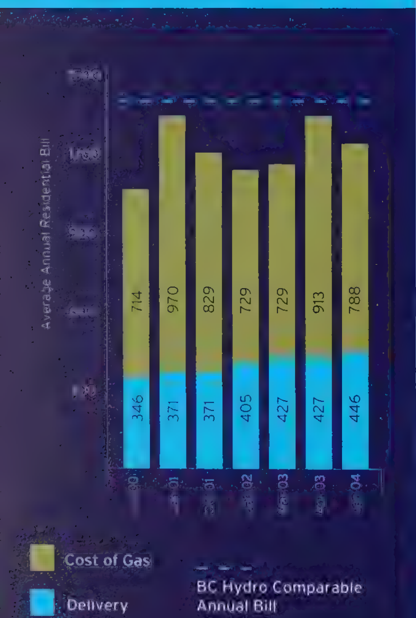
COMPETITIVENESS

Natural gas maintains a competitive advantage in terms of pricing when compared with alternative sources of energy in British Columbia. However, because electricity prices in British Columbia continue to be set based on the historical average cost of production, rather than based on market forces, they have remained artificially low compared to market priced electricity and, as a result, marginally higher than comparable natural gas costs. Over time, these pricing signals may distort energy use decisions by British Columbia consumers, thereby decreasing the use of natural gas by customers. In December 2003, BC Hydro filed a revenue requirements application with the BCUC, requesting a nine per cent rate increase to be spread over two years.

Fluctuations in use per residential and commercial customer, whether arising from weather or price levels, are deferred and recovered in customer rates and have no earnings impact on the Company.

The Company also employs a number of tools to reduce its exposure to natural gas price volatility. These include purchasing gas for storage and adopting hedging strategies, which include a combination of both physical and financial transactions, to reduce price volatility and ensure natural gas commodity costs remain competitive against electric rates. The Company's plan for hedging gas prices is filed with and accepted by the BCUC and activities under this plan are monitored by the BCUC

Lower Mainland Annual Bill History Gas vs. Electric Comparison
Dollars



In December 2003, BC Hydro requested a nine per cent increase in electricity rates to be spread over two years.

New customer additions at Terasen Gas and TGVI are typically a result of population growth and new housing starts, which are affected by the state of the provincial economy. The Company is also affected by changes in trends in housing starts from single family dwellings to multi-family dwellings, for which natural gas has a lower penetration rate. While new housing starts have increased in B.C. in 2003, growth of new multi-dwelling housing starts has significantly outpaced that of new single-family housing starts.

Trans Mountain's pipeline to the West Coast of North America and the Express System pipeline to the U.S. Rocky Mountains and Midwest are two of several pipeline alternatives for Western Canadian petroleum production, and throughput on these pipelines may decline if overall petroleum production in Alberta declines or if tolls become uncompetitive compared to alternatives. The Company's oil transportation business competes against other pipeline capacity providers who could be in a position to offer rolled in tolls, which may provide a competitive advantage in new pipeline development. Throughput on Trans Mountain may decline in situations where West Coast petroleum prices, net of transportation costs, are relatively lower than alternative prices in the U.S. Midwest. Throughput on the Express System may decline as a result of reduced petroleum product demand in the U.S. Rocky Mountains.

Refined products can be imported for the British Columbia market through marine offloading facilities in the Port of Vancouver or by truck transportation from refineries in Washington State. In 2003, refined products for the British Columbia market averaged 78,700 bbl/day or approximately 36% of Trans Mountain's total deliveries. The primary risk of reduced refined products deliveries will increase when the regulations reducing the allowable sulphur content of gasoline and diesel fuel take effect in 2005 and 2006, respectively, if increases in

sulphur concentration when transported in the Trans Mountain pipeline are not capable of being handled. Trans Mountain is working with the refined product shippers to more fully understand the mechanisms leading to sulphur pickup by refined products and apply those findings to implement measures to reduce or mitigate the increases in sulphur concentration. It is expected that gasoline movements will continue, but new clean-up technologies will have to be employed by refiners to meet the restrictive diesel regulations.

Petroleum transportation revenues are affected by changes in throughput volumes. However, under the incentive toll settlement for the Trans Mountain Canadian mainline, this risk is mitigated by a mechanism that permits Trans Mountain to recover net revenue shortfalls arising from average throughput below 179,000 bbl/day through toll adjustments in subsequent years. The risk of declines in Express revenues is mitigated by shipper firm service contracts as noted in the section Regulation — Express System.

GAS SUPPLY

By bringing the Southern Crossing Pipeline into service, Terasen Gas improved the security and competitiveness of the gas supply arrangements in place for Terasen Gas' customers. To the extent possible, Terasen Gas and TGVI have also minimized gas supply and price risk through the use of long-term transportation, storage and supply contracts, hedging instruments and a diverse supply portfolio.

However, local market prices have been higher than prices elsewhere in North America from time to time as a result of insufficient pipeline capacity to serve the increasing demand for natural gas in B.C. and the U.S. Pacific Northwest. In addition, Terasen Gas and TGVI continue to be dependent on a limited selection of pipeline and storage providers, particularly in the Lower Mainland and Vancouver Island service areas where the majority of the Company's natural gas distribution customers are located. Terasen is actively exploring opportunities to cost-effectively expand pipeline capacity to the Lower Mainland through initiatives such as the Inland Pacific Connector Project, a proposal to extend the Southern Crossing Pipeline from Oliver (in the interior of British Columbia) to the regional natural gas trading hub of Sumas, near Vancouver.

TGVI is served by a single source transmission pipeline. In the event of a service disruption on the transmission system, the Vancouver Island portion of the system could be affected for an extended period of time, thereby affecting revenues. Proceeding with the proposed LNG storage facility on Vancouver Island would reduce this exposure.

INTEREST RATES AND FOREIGN EXCHANGE

Terasen's earnings are sensitive to interest rates in several ways. Some outstanding debt has exposure to short-term interest rates, and is not subject to regulatory interest deferral accounts. In addition, the allowed returns on equity for Terasen Gas, TGVI and Corridor are determined by formulae that result in lower allowed ROEs if long-term Canada bond yields decline. As a result, if short-term interest rates increased by 1.0% for an extended period of time, the estimated impact on Terasen's annual consolidated net earnings would be a reduction of approximately \$3.6 million, whereas a similar increase in long-term interest rates would be expected to increase annual net earnings by approximately \$9.2 million.

In addition, a component of Terasen's earnings, principally earnings from Trans Mountain's U.S. pipeline and the Express System, are denominated in U.S. dollars. As a result, an annual decline of $0.10 in the price of a U.S. dollar in Canadian dollars would be expected to result in a decrease in annual consolidated net earnings of approximately Cdn$2.0 million.

Working capital and future income tax balances of the Company's interest in the Express System are denominated in U.S. dollars and are subject to quarterly revaluation based on prevailing foreign exchange rates. Terasen has entered into a foreign exchange hedging transaction, which is designed to reduce the Company's exposure to this risk.

The sensitivities described above are based on Terasen's business profile as at December 31, 2003 and may change over time as a result of changes in Terasen's business profile.

Terasen Inc. has hedging programs in place for its interest rate and foreign exchange risks which have been factored into the sensitivities described above, and which are described in note 14 to the consolidated financial statements.

NEW ACCOUNTING POLICIES

STOCK-BASED COMPENSATION

In the fourth quarter of 2003, the Company adopted the new Canadian Institute of Chartered Accountants (CICA) standard for stock-based compensation. The new standard affects the accounting for shares issued under Terasen's employee share option plan. The fair value of the option at the date it is granted is used to determine the compensation expense to be incurred over the vesting period. Using the Black-Scholes valuation model, the fair value of stock compensation granted in 2003 is approximately $1.9 million. As these stock options vest on a straight-line basis over a three-year period, Terasen will record a charge of approximately $0.6 million to earnings in each of 2003, 2004 and 2005. Any options granted in 2004 would be charged over the period from 2004 to 2006, assuming the same vesting period.

IMPAIRMENT OF LONG-LIVED ASSETS

The CICA has amended its standard on the recognition, measurement and disclosure of the impairment of long-lived assets under CICA Section 3063 "Impairment of Long-Lived Assets." This standard requires that an impairment loss be recognized when the carrying amount of a long-lived asset exceeds the sum of the undiscounted cash flows expected from its use and eventual disposition. As at December 31, 2003, the Company had no assets which would be affected by impairment.

FINANCIAL INSTRUMENTS

The CICA is assessing a possible amendment to Section 3860 "Financial Instruments — Disclosure and Presentation," which would require obligations that can be settled at the issuer's option by a variable number of the issuer's own equity instruments to be presented as liabilities. This amendment would require Terasen to classify $125.0 million of capital securities as debt rather than as a component of shareholder's equity, with an annual pre-tax expense of $10 million to be recorded as financing costs, as opposed to a direct charge to retained earnings. There would be no impact on earnings per share or earnings applicable to common shares.

VARIABLE INTEREST ENTITIES

The CICA has issued Accounting Guideline 15 "Consolidation of Variable Interest Entities," which requires entities to consolidate those companies in which it holds a significant interest if it meets certain risk and reward criteria. This guideline will require Terasen to consolidate the Coastal Facilities synthetic lease, which is currently an off-balance sheet lease. The implementation of this guideline has been delayed to fiscal years beginning on or after November 1, 2004. In accordance with this guideline, commencing January 1, 2005, Terasen will begin consolidating the Coastal Facilities lease.

ASSET RETIREMENT OBLIGATIONS

The CICA has adopted Accounting Section 3110 "Asset Retirement Obligations," which addresses the recognition and measurement of liabilities for obligations associated with the retirement of property, plant and equipment when those obligations result from the acquisition, construction, development or normal operation of the assets. The Section requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value is added to the carrying amount of the associated asset. The liability is accreted at the end of each period through charges to operating expenses. Section 3110 is not expected to have a significant impact on the Company's financial statements.

RATE REGULATED ENTITIES

The CICA has completed an initial report on rate regulated entities and intends to hold roundtable discussions on the topic of rate regulated entities. The purpose of the review is to address misgivings of the CICA over the reporting of certain assets and liabilities by rate regulated entities. Several of the Company's accounting practices are governed by rate regulation. These include, but are not limited to, accounting for property, plant and equipment, rate stabilization accounts, deferred charges and future income tax. In the event that the CICA were to change the method of accounting for rate regulated entities, and subject to regulatory review of implications, this could have a significant impact on the Company's financial reporting.

Management's Responsibility

The consolidated financial statements have been prepared by management, which is responsible for the integrity and objectivity of this information. These financial statements have been prepared in conformity with Canadian generally accepted accounting principles and, where appropriate, include amounts that are based on management's best estimates and judgments. The financial information presented elsewhere in the annual report is consistent with that in the consolidated financial statements.

Management has established systems of internal control which are designed to provide reasonable assurance that assets are safeguarded from loss and that reliable financial records are maintained. These systems are monitored by internal auditors.

KPMG LLP, the auditors appointed by the shareholders, have reviewed the systems of internal control and examined the consolidated financial statements in accordance with Canadian generally accepted auditing standards to enable them to express an independent opinion on the consolidated financial statements. Their report is set out below.

The Board of Directors, through its Audit Committee, oversees management's responsibilities for financial reporting and internal control. The Audit Committee meets with the internal auditors, the independent auditors and management to discuss auditing and financial matters and to review the consolidated financial statements and the independent auditors' report. The Audit Committee reports its findings to the Board for consideration in approving the consolidated financial statements for issuance to the shareholders.

J. M. Reid

John M. Reid
President and Chief Executive Officer

Gordon Barefoot

Gordon R. Barefoot
Senior Vice President, Finance, and Chief Financial Officer

Vancouver, Canada
February 2, 2004

Auditors' Report to the Shareholders

We have audited the consolidated statements of financial position of Terasen Inc. (formerly BC Gas Inc.) as at December 31, 2003 and 2002 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles. As required by the *Company Act* (British Columbia), we report that, in our opinion, these principles have been applied, before giving effect to the change in the method of accounting for stock-based compensation as explained in the notes to the consolidated financial statements, on a consistent basis.

KPMG LLP

Chartered Accountants

Vancouver, Canada
February 2, 2004

Consolidated Statements of Earnings
In millions of dollars, except per share amounts

Years ended December 31	2003	2002
Revenues		
Natural gas distribution	$ 1,497.9	$ 1,402.7
Petroleum transportation	200.0	136.0
Other activities	178.7	168.5
	1,876.6	1,707.2
Expenses		
Cost of natural gas	889.7	807.2
Operation and maintenance	313.6	289.3
Depreciation and amortization	133.4	115.6
Property and other taxes	69.9	66.1
Cost of revenues from other activities	103.6	92.5
	1,510.2	1,370.7
Operating Income	366.4	336.5
Financing costs (note 12)	176.0	160.8
Earnings before share of earnings of Express System and income taxes	190.4	175.7
Share of earnings of Express System (note 3)	8.0	—
Earnings before income taxes	198.4	175.7
Income taxes (note 13)	59.0	63.2
Net Earnings	139.4	112.5
Capital securities distributions, net of income taxes (note 9)	6.7	6.7
Earnings Applicable To Common Shares	$ 132.7	$ 105.8
Common shares — weighted average (millions)	51.9	43.2
Basic Earnings Per Common Share (note 9)	$ 2.56	$ 2.45
Diluted Earnings Per Common Share (note 9)	$ 2.53	$ 2.43

Consolidated Statements of Retained Earnings
In millions of dollars

Years ended December 31	2003	2002
Retained earnings, beginning of year	$ 302.2	$ 271.0
Net earnings	139.4	112.5
	441.6	383.5
Dividends on common shares	79.4	59.8
Capital securities distributions, net of income taxes	6.7	6.7
Share issue costs, net of income taxes (note 9)	—	13.8
Share options purchased (note 10)	—	1.0
	86.1	81.3
Retained earnings, end of year	$ 355.5	$ 302.2

Consolidated Statements of Financial Position

In millions of dollars

As at December 31	2003	2002
Assets		
Current assets		
Cash and short-term investments	**$ 1.5**	$ 5.1
Accounts receivable	**404.3**	299.2
Inventories of gas in storage and supplies	**142.4**	98.2
Prepaid expenses	**13.4**	11.1
Current portion of rate stabilization accounts (note 6)	**15.4**	69.3
	577.0	482.9
Property, plant and equipment (note 5)	**3,882.4**	3,779.2
Investment in Express System (note 3)	**204.6**	—
Goodwill	**101.9**	101.0
Rate stabilization accounts (note 6)	**75.7**	72.5
Other assets (note 7)	**73.5**	86.8
	$ 4,915.1	$ 4,522.4
Liabilities and Shareholders' Equity		
Current liabilities		
Short-term notes	**$ 553.9**	$ 440.0
Accounts payable and accrued liabilities	**364.5**	298.1
Income and other taxes payable	**43.9**	31.9
Current portion of long-term debt (note 8)	**51.8**	108.9
	1,014.1	878.9
Long-term debt (note 8)	**2,301.1**	2,123.4
Other long-term liabilities and deferred credits	**102.8**	96.4
Future income taxes (note 13)	**67.5**	58.1
	3,485.5	3,156.8
Shareholders' equity		
Capital securities (note 9)	**125.0**	125.0
Common shares (note 9)	**868.7**	858.6
Contributed surplus	**131.4**	130.8
Retained earnings	**355.5**	302.2
	1,480.6	1,416.6
Less cost of common shares held by Terasen Pipelines (Trans Mountain) Inc.	**51.0**	51.0
	1,429.6	1,365.6
	$ 4,915.1	$ 4,522.4

Approved by the Board:

Mark L. Cullen

Mark L. Cullen
Director

J.M. Reid

John M. Reid
Director

Consolidated Statements of Cash Flows

In millions of dollars

Years ended December 31		2003		2002
Cash flows provided by (used for)				
Operating activities				
Net earnings	$	**139.4**	$	112.5
Adjustments for non-cash items				
Depreciation and amortization		**133.4**		115.6
Share of earnings from Express System, net of (in excess of) cash distributions		**2.1**		—
Future income taxes		**9.4**		10.6
Other		**8.0**		5.3
		292.3		244.0
Decrease in rate stabilization accounts		**50.7**		66.9
Changes in non-cash operating working capital		**(73.2)**		7.2
		269.8		318.1
Investing activities				
Property, plant and equipment		**(222.9)**		(395.7)
Acquisition of Express System (note 3)		**(206.7)**		—
Acquisition of Terasen Gas (Vancouver Island) (note 3)		**—**		(305.2)
Proceeds on sale of natural gas distribution assets (note 15)		**—**		23.8
Other assets		**(2.3)**		(33.8)
		(431.9)		(710.9)
Financing activities				
Increase in short-term notes		**113.9**		135.0
Increase in long-term debt		**461.4**		84.5
Reduction of long-term debt		**(340.8)**		(231.4)
Issue of common shares, net of issue costs (note 9)		**10.1**		475.2
Dividends and distributions on common shares and capital securities		**(86.1)**		(66.5)
Share options purchased		**—**		(1.0)
		158.5		395.8
Net increase (decrease) in cash		**(3.6)**		3.0
Cash at beginning of year		**5.1**		2.1
Cash at end of year	$	**1.5**	$	5.1
Supplemental cash flow information				
Interest paid in the year	$	**184.7**	$	180.8
Income taxes paid in the year		**47.9**		19.7

Cash is defined as cash or bank indebtedness

Tabular amounts in millions of dollars, except where stated otherwise
Years ended December 31, 2003 and 2002

Terasen Inc. provides energy transportation and utility asset management services. Terasen operates in two primary business segments.

(a) Natural gas distribution operations involve the transmission and distribution of natural gas for residential, commercial, institutional and industrial customers in British Columbia. The operations are conducted through Terasen Gas Inc. ("Terasen Gas"), serving the Lower Mainland and interior of British Columbia, Terasen Gas (Vancouver Island) Inc. ("TGVI"), serving Vancouver Island and the Sunshine Coast, Terasen Gas (Whistler) Inc., and Terasen Gas (Squamish) Inc.

(b) Petroleum transportation operations are carried out through Terasen Pipelines (Trans Mountain) Inc. ("Trans Mountain"), which owns and operates a common carrier pipeline system for crude and refined petroleum products, Terasen Pipelines (Corridor) Inc. ("Corridor"), a pipeline in Northern Alberta transporting diluted bitumen, and Express Pipeline Ltd. and Express US Holdings LP ("the Express System"). The Express System, in which the Company has a one-third ownership interest, transports crude oil from Hardisty, Alberta, through the Rocky Mountain region of the United States and on to Wood River, Illinois.

The Company's other activities include non-regulated energy and utility businesses as well as corporate financing costs and administration charges. The non-regulated businesses include water and utility services, international consulting, natural gas vehicle fuelling and utility customer care services. The Company also operates in the United States. At the present time, these other businesses and the United States' operations are not of sufficient size to be reportable as operating or geographic segments. On April 25, 2003, the Company changed its name from BC Gas Inc. to Terasen Inc.

1. Significant Accounting Policies

The preparation of these consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses in the financial statements, as well as the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

In the opinion of Management, these consolidated financial statements have been properly prepared within reasonable limits of materiality and reflect the following summary of significant accounting policies.

Basis of Presentation

The consolidated financial statements include the accounts of the Company, its subsidiaries, and its proportionate share of the accounts of joint ventures. Investments in entities which are not subsidiaries or joint ventures, but over which the Company exercises significant influence, are accounted for using the equity method.

Regulation

The natural gas distribution companies are subject to the regulation of the British Columbia Utilities Commission ("the BCUC"). The Trans Mountain and Express System operations are regulated in Canada by the National Energy Board and, in the United States, tariff matters are regulated by the Federal Energy Regulatory Commission.

These regulatory authorities exercise statutory authority over such matters as rates of return, construction and operation of facilities, accounting practices, rates and tolls, and contractual agreements with customers. With respect to Corridor, these matters are governed by contractual arrangements with shippers and are subject to regulation by the Alberta Energy and Utilities Board.

In order to recognize the economic effects of regulation, the timing of recognition of certain revenues and expenses in these operations may differ from that otherwise expected under generally accepted accounting principles.

Inventories

Inventories of gas in storage are valued at weighted-average cost. Supplies and other inventories are valued at the lower of cost and net realizable value.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Cost includes all direct expenditures for system expansions, betterments and replacements, an allocation of overhead costs and an allowance for funds used during construction.

Depreciation of regulated assets is recorded on a straight-line basis on plant in service at rates approved by regulatory authorities. Depreciation rates require the use of management estimates of the useful lives of assets. The cost of depreciable property retired, together with removal costs less salvage, is charged to accumulated depreciation. When allowed by the regulators, regulated operations capitalize an allowance for equity funds used during construction at approved rates.

Depreciation of non-regulated equipment is recorded using the declining balance method.

Future removal and site restoration costs are not determinable and will be recognized when reasonably estimable and when approved by regulators. Accordingly, no provision has been made for these costs and there is a reasonable expectation that the costs would be recoverable through future rates or tolls.

Rate Stabilization Accounts

TGVI maintains a BCUC-approved Revenue Deficiency Deferral Account ("RDDA") to accumulate unrecovered costs of providing service to customers. The RDDA accumulates the difference between revenues and costs for recovery through future rates.

Terasen Gas is authorized by the BCUC to maintain two rate stabilization accounts to mitigate the effect on its earnings of unpredictable and uncontrollable factors, principally weather and natural gas cost volatility. The Gas Cost Reconciliation Account ("GCRA") accumulates differences between actual natural gas costs and forecast natural gas costs as recovered in base rates. The Revenue Stabilization Adjustment Mechanism ("RSAM") accumulates the margin impact of variations in the actual versus forecast use for residential and commercial customers.

All rate stabilization account balances are amortized and recovered through rates as approved by the BCUC.

Deferred Charges
The Company defers certain charges which the regulatory authorities or contractual arrangements require or permit to be recovered through future rates or tolls. Deferred charges are amortized over various periods depending on the nature of the charges and include long-term debt issue costs which are amortized over the term of the related debt.

Deferred charges not subject to regulation relate to projects which may benefit future periods and will be capitalized on completion, expensed on project abandonment, or are being amortized on a straight-line basis over periods of up to ten years.

Goodwill
Goodwill represents the excess of an investment over the fair value of the net assets acquired. Goodwill is tested annually for impairment by comparing the book value with the fair value of the goodwill of the reporting unit to which the goodwill is attributable. Any deficiency in the book value compared to the fair value will be recognized as an impairment loss.

Revenue Recognition
The Company recognizes revenues when products have been delivered or services have been performed.

The natural gas distribution utilities record revenues from natural gas sales on the basis of regular meter readings and estimates of customer usage since the last meter reading date to the end of the year and adjusted for the Revenue Stabilization Adjustment Mechanism and other BCUC-approved orders.

For the petroleum transportation operations, revenues are recorded when products are delivered and adjusted according to terms prescribed by toll settlements with the shippers and approved by the respective regulator.

Post-Employment Benefit Plans
The Company maintains both defined benefit and defined contribution pension plans. Defined benefit pension costs and obligations are actuarially determined using the projected benefit method. The Company accrues the cost of defined benefit pensions as the employee provides services, except when regulatory recovery in rates requires costs to be expensed as paid. Pension plan assets are measured at fair value. Defined contribution plan costs are expensed by the Company as contributions are payable.

The Company provides post-employment benefits other than pensions, including group health care and life insurance benefits for eligible retirees. The cost of such benefits are actuarially determined and are accrued as the employee provides service, except when regulatory recovery in rates requires costs to be expensed as paid.

Income Taxes
The Company's regulated operations account for and recover income tax expense in rates as prescribed by their respective regulators. This includes accounting for income taxes by the taxes payable method and accounting for certain deferral and rate stabilization accounts on a net of realized tax basis. Therefore, future income taxes related to temporary differences are not recorded. The taxes payable method is followed as there is reasonable expectation that all future income taxes will be recovered in rates when they become payable.

The Company's non-regulated operations follow the asset and liability method of accounting for income taxes. Future income tax assets and liabilities are determined based on temporary differences between the tax bases of assets and liabilities and their carrying values for accounting purposes. Future income tax assets and liabilities are measured at the tax rate that is expected to apply when the temporary differences reverse.

Stock-Based Compensation
Effective January 1, 2002, the Company applied the requirements of the CICA Handbook Section 3870 in respect of Stock-Based Compensation and Other Stock-Based Payments. The new standard was mandatory for fiscal years beginning on or after January 1, 2002. Under the standard, the Company applied the settlement method of accounting for stock options, whereby any consideration paid by employees on the exercise of stock options is credited to common shares and no compensation expense is recognized. As required under the standard, pro forma earnings and earnings per share disclosures were made for the impact of the fair value based method of accounting for stock options.

The CICA Accounting Standards Board has amended Handbook Section 3870 to require companies to account for employee stock options using the fair value based method, beginning January 1, 2004. Under the fair value based method, compensation cost is measured at the fair value at the date of grant and is expensed over the award's vesting period. In accordance with the transitional option permitted under the amended Section 3870, the Company has elected to prospectively apply the fair value based method to all options granted on or after January 1, 2003.

2. Segment Disclosures

2003	Natural gas distribution	Petroleum transportation	Other activities	Total
Revenues	$ 1,497.9	$ 200.0	$ 178.7	$ 1,876.6
Cost of natural gas	889.7	—	—	889.7
Operation and maintenance	189.4	57.0	67.2	313.6
Depreciation and amortization	92.5	30.0	10.9	133.4
Property and other taxes	48.6	21.0	0.3	69.9
Cost of revenues	—	—	103.6	103.6
	1,220.2	108.0	182.0	1,510.2
Operating income	277.7	92.0	(3.3)	366.4
Financing costs	135.5	23.2	17.3	176.0
Share of earnings of Express System	—	8.0	—	8.0
Income taxes (recovery) on earnings	46.8	20.6	(8.4)	59.0
Net earnings (loss)	95.4	56.2	(12.2)	139.4
Earnings (loss) applicable to common shares	95.4	56.2	(18.9)	132.7
Earnings (loss) per common share	1.84	1.08	(0.36)	2.56
Total assets	3,416.4	1,337.6	161.1	4,915.1
Goodwill	76.5	—	25.4	101.9
Capital expenditures	135.1	77.2	10.6	222.9

2002	Natural gas distribution	Petroleum transportation	Other activities	Total
Revenues	$ 1,402.7	$ 136.0	$ 168.5	$ 1,707.2
Cost of natural gas	807.2	—	—	807.2
Operation and maintenance	179.3	43.8	66.2	289.3
Depreciation and amortization	92.6	17.1	5.9	115.6
Property and other taxes	46.9	18.7	0.5	66.1
Cost of revenues	—	—	92.5	92.5
	1,126.0	79.6	165.1	1,370.7
Operating income	276.7	56.4	3.4	336.5
Financing costs	136.8	9.5	14.5	160.8
Income taxes (recovery) on earnings	47.5	17.6	(1.9)	63.2
Net earnings (loss)	92.4	29.3	(9.2)	112.5
Earnings (loss) applicable to common shares	92.4	29.3	(15.9)	105.8
Earnings (loss) per common share	2.14	0.68	(0.37)	2.45
Total assets	3,282.5	1,078.6	161.3	4,522.4
Goodwill	76.5	—	24.5	101.0
Capital expenditures	130.2	246.3	19.2	395.7

3. Acquisitions and Related Financings

Express System

On January 9, 2003, a consortium including the Company, Borealis Infrastructure Management Inc. and the Ontario Teachers' Pension Plan Board acquired all of the outstanding shares of Express Pipeline Ltd. and Express Holdings (U.S.A.) Inc. from EnCana Corporation. Each of the three consortium members owns an equal interest in the Express System. The total purchase price was $1,203.5 million, including assumed debt of $578.8 million. The Company's share of the purchase price was $206.7 million.

The December 2002 issue of common shares, which yielded gross proceeds of $301.4 million, was completed in part to finance the purchase of the Company's share of the Express System.

The Company exercises significant influence over the Express System and, accordingly, accounts for its one-third investment in the Express System using the equity method. Under the equity method the investment has been initially recorded at cost, and is subsequently adjusted to recognize the Company's share of earnings of the Express System and is reduced by distributions.

Terasen Gas (Vancouver Island) Inc.

The Company acquired all of the outstanding shares and inter-corporate debt of Terasen Gas (Vancouver Island) Inc. and Terasen Gas (Whistler) Inc., formerly Centra Gas British Columbia Inc. and Centra Gas Whistler Inc. (collectively "TGVI") effective January 1, 2002. The results of TGVI's operations have been included in the consolidated financial statements since that date.

The aggregate purchase price was $333.4 million, including $305.2 million paid in cash and a $52.0 million deferred payment with a present value of $28.2 million. The deferred payment is payable on December 31, 2011 or sooner if TGVI realizes revenues from transportation contracts to serve power-generating plants which may be constructed in TGVI's service area. If any part of the deferred payment is paid prior to December 31, 2011, the difference between the payment and the carrying value of the debt will be treated as contingent consideration and added to the cost of the purchase at that time.

The following table summarizes the fair value assigned to the assets acquired and liabilities assumed at January 1, 2002.

Current assets	$ 34.3
Property, plant and equipment	432.9
Rate stabilization account	61.0
Goodwill	75.9
Deferred charges	8.4
Future income taxes	3.0
Total assets acquired	615.5
Current liabilities	(44.2)
Long-term debt	(224.1)
Other long-term liabilities	(13.8)
Total liabilities assumed	(282.1)
Net assets acquired	$ 333.4

The acquisition was financed by the issuance of 5,208,000 common shares with gross proceeds of $188.3 million and by debt of $145.1 million. The common shares were issued pursuant to an agreement whereby, on November 20, 2001, the Company issued 5,208,000 subscription receipts at a price of $36.15 per subscription receipt. Proceeds from the sale were held in escrow by a trustee until the closing of the acquisition, when each subscription receipt was converted into one common share of the Company.

4. Restructuring

During the year ended December 31, 2003, the Company's natural gas distribution operations undertook a management and administrative restructuring and integration. The initiative was undertaken to generate efficiencies and harmonize processes and systems between Terasen Gas Inc. and Terasen Gas (Vancouver Island) Inc. As a result of the restructuring, natural gas distribution operations recorded a fourth quarter charge of $3.4 million, net of previously recorded accruals, tax and the deferral of an amount for future recovery from customers through rates. The pre-tax charge is included in operations and maintenance expense. Future charges related to the restructuring are not expected to be material to the financial statements.

5. Property, Plant and Equipment

2003	Cost	Accumulated depreciation	Net book value
Natural gas distribution systems	**$ 2,979.2**	**$ 486.7**	**$ 2,492.5**
Petroleum pipeline systems	**1,260.0**	**265.6**	**994.4**
Plant, buildings and equipment	**409.8**	**154.2**	**255.6**
Land and land rights	**141.8**	**1.9**	**139.9**
	$ 4,790.8	**$ 908.4**	**$ 3,882.4**

2002			
Natural gas distribution systems	$ 2,891.7	$ 439.6	$ 2,452.1
Petroleum pipeline systems	533.8	243.0	290.8
Petroleum pipeline under construction	643.7	—	643.7
Plant, buildings and equipment	393.7	134.2	259.5
Land and land rights	134.6	1.5	133.1
	$ 4,597.5	$ 818.3	$ 3,779.2

The weighted average depreciation rate on regulated property, plant and equipment for the year ended December 31, 2003 is approximately 2.9% (2002–2.8%).

6. Rate Stabilization Accounts

	2003	2002
Revenue Deficiency Deferral Account (RDDA)	**$ 56.3**	$ 65.1
Gas Cost Reconciliation Account (GCRA)	**(6.2)**	42.2
Revenue Stabilization Adjustment Mechanism (RSAM)	**41.0**	34.5
Total rate stabilization accounts	**91.1**	141.8
Less current portion of rate stabilization accounts	**15.4**	69.3
	$ 75.7	$ 72.5

The current portion of the rate stabilization accounts represents the amounts expected to be recovered in rates over the next twelve months. Actual recoveries will vary depending on actual natural gas consumption and recovery amounts approved by the BCUC.

7. Other Assets

	2003	2002
Deferred charges		
Regulated	**$ 42.3**	$ 48.3
Non-regulated	**19.4**	16.9
Investments	**2.6**	8.8
Long-term receivables	**9.2**	12.8
	$ 73.5	$ 86.8

8. Long-Term Debt

	2003	2002
Terasen Inc.		
(a) Medium Term Note Debentures:		
6.30% Series 1, due December 1, 2008	**$ 200.0**	$ 200.0
4.85% Series 2, due May 8, 2006	**100.0**	—
	300.0	200.0
Terasen Gas Inc.		
(b) Purchase Money Mortgages:		
11.80% Series A, due September 30, 2015	**74.9**	74.9
10.30% Series B, due September 30, 2016	**200.0**	200.0
(c) Debentures and Medium Term Note Debentures:		
9.75% Series D, due December 17, 2006	**20.0**	20.0
10.75% Series E, due June 8, 2009	**59.9**	59.9
8.15% Series H, due July 28, 2003	**—**	50.0
6.20% Series 9, due June 2, 2008	**188.0**	188.0
6.95% Series 11, due September 21, 2029	**150.0**	150.0
6.50% Series 12, due July 20, 2005	**200.0**	200.0
6.50% Series 13, due October 16, 2007	**100.0**	100.0
6.00% Series 14, due October 23, 2003	**—**	50.0
6.15% Series 16, due July 31, 2006	**100.0**	100.0
Floating Rate Series 17, due September 26, 2005	**150.0**	—
Various series, weighted average interest rate of 9.63% (2002–9.63%) due in 2005	**45.0**	45.0
Obligations under capital leases, at 6.20% (2002–6.43%)	**11.7**	12.5
	1,299.5	1,250.3
Terasen Gas (Vancouver Island) Inc.		
(d) Syndicated credit facility at short-term floating rates, weighted average interest rate of 3.51% with annual repayments of $5.4 million in 2004 and 2005 and maturities of $176.5 million in 2006 and $33.0 million in 2009	**220.4**	224.2
Terasen Pipelines (Trans Mountain) Inc.		
(e) Debentures:		
10.75% Series B, due November 22, 2004	**30.0**	30.0
11.50% Series C, due June 20, 2010	**35.0**	35.0
	65.0	65.0
Terasen Pipelines (Corridor) Inc.		
(f) Commercial Paper at short-term floating rates, weighted average interest rate of 2.69% (2002–2.89%)	**464.0**	487.0
Other long-term debt	**4.0**	5.8
Total long-term debt	**2,352.9**	2,232.3
Less: current portion of long-term debt	**51.8**	108.9
	$ 2,301.1	$ 2,123.4

(a) Terasen Inc. Medium Term Note Debentures:
The Company's Medium Term Note Debentures are unsecured obligations but are subject to the restrictions of the Trust Indenture dated November 21, 2001.

(b) Terasen Gas Inc. Purchase Money Mortgages:
The Series A and Series B Purchase Money Mortgages are secured equally and rateably by a first fixed and specific mortgage and charge on Terasen Gas' Coastal Division assets, and are subject to the restrictions of the Trust Indenture dated December 3, 1990. The aggregate principal amount of Purchase Money Mortgages that may be issued under the Trust Indenture is limited to $425 million.

(c) Terasen Gas Inc. Debentures and Medium Term Note Debentures:
Terasen Gas' debentures are unsecured obligations but are subject to the restrictions of the Trust Indenture dated November 1, 1977, as amended and supplemented.

(d) Terasen Gas (Vancouver Island) Inc. Bank Syndicate:
The credit facility from the syndicate of banks is secured by a first floating charge over all of the assets of TGVI, assignment of material contracts, and assignment of royalty revenue and interruptible incentive payments.

(e) Terasen Pipelines (Trans Mountain) Inc. Debentures:
The Trans Mountain debentures are unsecured obligations but are subject to the restrictions of the Trust Indenture dated February 18, 1987, as amended and supplemented.

(f) Terasen Pipelines (Corridor) Inc. Commercial Paper:
The commercial paper program to finance the Corridor pipeline is supported by a syndicated bank credit facility that is committed until November 21, 2006.

The Company's Series 1 Medium Term Note Debentures, Terasen Gas' Series B Purchase Money Mortgages, Series E Debentures, and Series 11, Series 13, and Series 16 Medium Term Note Debentures, and Trans Mountain's Series B and Series C Debentures are redeemable in whole or in part at the option of the Company at a price equal to the greater of the Canada Yield Price, as defined in the applicable Trust Indenture, and the principal amount of the debt to be redeemed, plus accrued and unpaid interest to the date specified for redemption. The Canada Yield Price is calculated as an amount that provides a yield slightly above the yield on an equivalent maturity Government of Canada bond.

Required principal repayments over the next five years are as follows:

2004	$ 51.8
2005	416.2
2006	838.9
2007	102.3
2008	390.3

9. Capital Securities and Share Capital

Authorized Share Capital
The Company is authorized to issue 750,000,000 common shares, 100,000,000 first preference shares and 100,000,000 second preference shares, all without par value.

Capital Securities
On April 19, 2000, the Company issued $125.0 million of 8.0% Capital Securities with a term to maturity of 40 years for gross proceeds of $123.7 million. The Company may elect to defer payments on these securities and settle such deferred payments in either cash or common shares, and has the option to settle principal at maturity through the issuance of common shares. Accordingly, the capital securities have been classified as equity. The securities are exchangeable at the option of the holder on or after April 19, 2010 for common shares of the Company at 90% of the market price, subject to the right of the Company to redeem the securities for cash. Distributions on these securities, net of related income taxes, are deducted from net earnings for the purposes of calculating earnings applicable to common shares.

Common Shares
Changes in the issued and outstanding common shares are as follows:

	2003		2002	
	Number	Amount	Number	Amount
Outstanding, beginning of year	**56,274,005**	**$ 858.6**	42,936,059	$ 364.3
Issued under: Public and private placements	—	—	7,931,600	301.4
Conversion of subscription receipts	—	—	5,208,000	188.3
Share option plan	**390,901**	**9.9**	196,377	4.5
Employee share purchase plan	**4,565**	**0.2**	1,969	0.1
	56,669,471	**$ 868.7**	56,274,005	$ 858.6
Less common shares held by Trans Mountain	**4,592,094**		4,592,094	
Outstanding, end of year	**52,077,377**		51,681,911	

In March 2002, the Company issued 5,208,000 common shares for gross proceeds of $188.3 million through the conversion of subscription receipts, and in December 2002, the Company issued 7,931,600 common shares in concurrent public and private placements for gross proceeds of $301.4 million. Costs associated with the issuance of these shares of $13.8 million, net of current and future income taxes, have been recorded against retained earnings.

As at December 31, 2003, Trans Mountain owned 8.1% (2002–8.2%) of the common shares of Terasen Inc. The cost of these shares is shown as a deduction from shareholders' equity.

Reserved for Issue

At December 31, 2003, the number of common shares reserved for issue to meet rights outstanding is as follows:

Under share option plan	3,088,189
Under dividend reinvestment and share purchase plan	2,062,576
Under payroll deduction employee share purchase plan	407,978
	5,558,743

Earnings Per Share

Earnings per share is based on the weighted average number of common shares outstanding during the year. Diluted earnings per share is calculated using the treasury stock method based on the weighted average number of common shares, including stock options outstanding at the beginning of or granted during the year. The Company's performance-based share options are considered to be contingently issuable shares and have been included in the treasury stock method calculation only if all performance criteria of the options have been satisfied. The possible exchange of the $125.0 million Capital Securities into common shares has not been included in the treasury stock method calculation since similar obligations in the past have been paid wholly in cash.

	2003		2002	
	Weighted average shares	Earnings	Weighted average shares	Earnings
Earnings applicable to common shares		**$ 132.7**		$ 105.8
Weighted average common shares	**51.9**		43.2	
Add: weighted average number of shares that would be issued				
under treasury stock method	**0.5**		0.4	
	52.4	**$ 132.7**	43.6	$ 105.8
Earnings per share		**$ 2.56**		$ 2.45
Diluted earnings per share		**$ 2.53**		$ 2.43

Shareholder Rights Plan

The Company established a Shareholder Rights Plan in 2003 that is designed to encourage the fair treatment of shareholders in connection with any takeover offer for the Company. Rights issued under the plan become exercisable when a person or party acquires, or announces the intention to acquire, 20% or more of the Company's outstanding common shares without complying with certain provisions set out in the plan or without approval of the Board of Directors of the Company. Each common share outstanding is entitled to one right, which entitles the rights holder, other than the acquiring person or party, the right to purchase common shares of the Company at 50% of the then market price.

10. Share Option Plan and Stock-Based Compensation

Share Option Plan

The Company has a Share Option Plan whereby officers, directors and certain key employees may be granted options to purchase a maximum of 6,300,000 unissued common shares with terms up to ten years. There are two categories of options which have been issued under the Share Option Plan: Regular Share Options and Performance-Based Share Options. The option exercise price is the closing sale price of the common shares on the Toronto Stock Exchange on the trading day prior to the date the option is granted.

In 2002, the Company exercised its right under the Plan to require participants to determine whether or not to exercise the option for unissued common shares, thereby removing the cash settlement of vested options. Prior to the removal of the cash settlement option, share options to purchase 97,321 common shares were purchased in 2002 for $1.0 million, net of income tax benefits, which was charged to retained earnings.

Regular Share Options

Since 2000, the Company has granted options with eight-year terms which are exercisable on a cumulative basis and vest at one-third per year on the anniversary of the option grant date. Prior to 2000, the Company granted options with ten-year terms which are exercisable on a cumulative basis at 20% per year.

Regular Share Options Outstanding

	2003		2002	
	Shares under option	Weighted average exercise price	Shares under option	Weighted average exercise price
Outstanding, beginning of year	**683,738**	**$ 28.85**	610,849	$ 24.28
Options granted during the year	**63,572**	**28.55**	266,830	33.81
Options exercised	**(248,858)**	**24.42**	(109,619)	21.76
Options forfeited and expired	**(14,699)**	**33.95**	(4,551)	28.35
Options purchased	**—**	**—**	(79,771)	20.26
Outstanding, end of year	**483,753**	**$ 30.93**	683,738	$ 28.85
Options exercisable, end of year	**279,519**	**$ 27.44**	337,373	$ 24.51

	Options outstanding			Options exercisable	
Exercise price range	Shares under option	Weighted average exercise price	Weighted average remaining contractual life	Number exercisable at year-end	Weighted average exercise price
$13.87–$18.00	25,840	$ 14.57	0.7	25,840	$ 14.57
$21.20–$26.65	109,820	25.84	3.9	109,820	25.84
$27.50–$31.85	110,857	29.22	4.5	96,724	28.96
$35.12–$43.83	237,236	35.87	6.3	47,135	35.12
	483,753	$ 30.93	5.0	279,519	$ 27.44

Performance-Based Share Options

The Company has granted performance-based share options with eight-year terms. The options vest at one-third per year on the anniversary of the option grant dates, subject to the market price of the Company's common shares reaching 125% of the option's exercise price for at least 10 out of 15 consecutive trading days within four years of the option grant date. If the market price requirement is not attained within four years of grant date, the participant is still eligible to exercise two-thirds of the granted options if the common share price reaches 125% of the option's exercise price for at least 10 out of 15 consecutive trading days during the subsequent four years.

Performance-Based Share Options Outstanding

	2003		2002	
	Shares under option	Weighted average exercise price	Shares under option	Weighted average exercise price
Outstanding, beginning of year	**946,092**	**$ 31.06**	677,275	$ 27.66
Options granted during the year	**372,100**	**39.64**	386,400	35.21
Options exercised during the year	**(142,043)**	**27.13**	(86,758)	24.56
Options forfeited and expired	**(23,950)**	**38.52**	(13,275)	25.99
Options purchased	**—**	**—**	(17,550)	27.09
Outstanding, end of year	**1,152,199**	**$ 34.16**	946,092	$ 31.06
Options exercisable, end of year	**454,799**	**$ 25.58**	324,909	$ 27.31

	Options outstanding			Options exercisable	
Exercise price range	Shares under option	Weighted average exercise price	Weighted average remaining contractual life	Number exercisable at year-end	Weighted average exercise price
$22.50–$27.25	196,075	$ 25.58	3.7	196,075	$ 25.58
$31.00–$35.12	587,224	33.59	5.8	258,724	32.95
$39.20–$46.64	368,900	39.63	7.1	—	—
	1,152,199	$ 34.16	5.8	454,799	$ 25.58

Stock-Based Compensation

In 2003, 435,672 stock options were granted (2002–653,230) at an average exercise price of $38.02 (2002–$34.64) under the Company's Share Option Plan. The Company has applied the fair value based method of accounting for stock options granted after January 1, 2003. Reported earnings for 2003 include a compensation charge of $0.6 million representing the fair value of the vested 2003 grant, with a corresponding increase to contributed surplus. Had the Company used the fair value based method to account for stock options granted during 2002, pro forma earnings and earnings per share would have been as follows:

Years ended December 31		2003	2002
Net earnings (in millions)	As reported	**$ 139.4**	$ 112.5
	Pro forma	**$ 138.2**	$ 111.2
Earnings applicable to common shares (in millions)	As reported	**$ 132.7**	$ 105.8
	Pro forma	**$ 131.5**	$ 104.5
Basic earnings per common share As reported		**$ 2.56**	$ 2.45
	Pro forma	**$ 2.53**	$ 2.42
Diluted earnings per common share	As reported	**$ 2.53**	$ 2.43
	Pro forma	**$ 2.51**	$ 2.40

A Black-Scholes model was used to calculate stock option fair value. The weighted average fair value of options granted in 2003 was $5.02 (2002–$5.89). Significant assumptions in valuing the options in 2003 are as follows:

	Regular options	Performance-based options
Interest rate	3.8–4.2%	4.3–4.4%
Expected volatility	16.8–17.8%	16.2–17.8%
Expected life	5 years	6 years

11. Employee Benefit Plans

The Company and its subsidiaries have defined benefit pension plans and defined contribution pension plans for employees. The Company also provides post-employment benefits other than pensions for retired employees.

Defined Benefit Plans

Retirement benefits under the defined benefit plans are based on employees' years of credited service and remuneration. Company contributions to the plan are based upon independent actuarial valuations. The most recent actuarial valuations were completed as of December 31, 2002 and December 31, 2001. In 2003, plan assets were 60% invested in publicly traded equities and 40% in fixed income securities.

Defined benefit pension costs reflect management's best estimate of expected plan investment performance, salary escalation, mortality rates and retirement ages of plan members. Adjustments, in excess of 10% of the greater of benefit obligation and plan asset value that result from plan amendments, changes in assumptions and experience gains and losses, are amortized over the expected average remaining service life of the employee group covered by the plan.

Defined Contribution Plan

Effective 2000 for Terasen Gas and 2003 for petroleum transportation operations, all new non-union employees to the Company are members of a defined contribution pension plan. Company contributions to the plan are based upon employee age and pensionable earnings for the natural gas distribution operations and pensionable earnings for the petroleum transportation operation. For defined contribution benefit plans, pension expense equals required Company contributions.

Other Post-Employment Benefits

The Company provides retired employees with other post-employment benefits that include, depending on circumstance, supplemental health, dental and life insurance coverage. Post-employment benefits are unfunded and annual expense is recorded on an accrual basis based on independent actuarial determination, considering, among other factors, health care cost escalation.

Information about these benefit plans, in aggregate, is as follows:

	Defined benefit pension plans		Other benefit plans	
	2003	2002	**2003**	2002
Plan assets				
Fair value, beginning of year	**$ 221.2**	$ 223.7	**$ —**	$ —
Acquisition of Terasen Gas (Vancouver Island) assets	**—**	11.9	**—**	—
Acquisition of Express System	**1.9**	—	**—**	—
Actual return (loss) on plan assets	**31.1**	(8.0)	**—**	—
Employers' contributions	**10.2**	4.3	**1.2**	0.9
Employees' contributions	**2.8**	3.0	**—**	—
Benefits and settlements paid	**(11.4)**	(13.0)	**(1.1)**	(0.9)
Other	**(0.7)**	(0.7)	**(0.1)**	—
Fair value, end of year	**255.1**	221.2	**—**	—
Accrued benefit obligation				
Obligation, beginning of year	**250.8**	221.5	**49.9**	36.1
Acquisition of Terasen Gas (Vancouver Island) obligation	**—**	14.6	**—**	2.5
Acquisition of Express System	**1.4**	—	**0.6**	—
Current service cost	**7.9**	7.5	**1.5**	1.1
Interest cost	**16.6**	15.6	**3.4**	2.5
Employees' contributions	**2.8**	3.0	**—**	—
Benefits and settlements paid	**(11.4)**	(13.0)	**(1.1)**	(0.9)
Change in discount rate	**7.9**	7.0	**2.4**	0.9
Actuarial (gain) loss	**(2.0)**	(9.5)	**11.5**	8.2
Past service cost and other	**1.5**	4.1	**(7.2)**	(0.5)
Balance, end of year	**275.5**	250.8	**61.0**	49.9
Plan deficit	**(20.4)**	(29.6)	**(61.0)**	(49.9)
Unamortized transitional obligation (benefit)	**(31.0)**	(34.4)	**7.8**	18.3
Unamortized actuarial loss	**46.8**	54.8	**32.1**	14.3
Unamortized past service costs	**8.7**	8.0	**(3.5)**	0.2
Accrued benefit asset (liability)	**$ 4.1**	$ (1.2)	**$ (24.6)**	$ (17.1)

Included in the above defined benefit pension plans is a liability of $25.3 million at December 31, 2003 (2002–$23.7 million) regarding plans which have not been funded. These unfunded pension obligations are secured by letters of credit.

Net Benefit Plan Expense

	Pension benefit plans		Other benefit plans	
	2003	2002	**2003**	2002
Current service cost	**$ 7.9**	$ 7.5	**$ 1.5**	$ 1.1
Interest cost on projected benefit obligations	**16.6**	15.6	**3.4**	2.5
Expected return on plan assets	**(18.1)**	(17.8)	**—**	—
Amortization of transitional obligation (benefit)	**(3.4)**	(3.4)	**2.7**	2.7
Other	**2.0**	1.1	**1.1**	0.3
Net benefit plan expense	**$ 5.0**	$ 3.0	**$ 8.7**	$ 6.6
Defined contribution plan expense	**$ 1.6**	$ 1.2		
	$ 6.6	$ 4.2		

Significant Assumptions

The weighted average significant actuarial assumptions used in measuring the Company's accrued benefit obligations are as follows:

	Pension benefit plans		Other benefit plans	
	2003	2002	**2003**	2002
Discount rate at December 31, based on AA Corporate bond yields	**6.25%**	6.56%	**6.25%**	6.50%
Expected long-term rate of return on plan assets	**7.50%**	7.50%	**—**	—
Rate of compensation increase	**3.39%**	3.39%	**—**	—

Effective January 1, 2004, the Company modified its post-employment benefit program for non-union active employees in order to provide future retirees with more choice of coverage and to reduce the Company's exposure to future health and group life cost increases. The new plan is predominantly a defined contribution plan incorporating a Company-paid Health Spending account, a security health plan and life insurance. Provincial medical services plan premiums will now be paid by the retiree.

All plan members who have retired on or before December 31, 2003 receive benefits under the plans that were in effect when they retired, which includes the payment of provincial medical services plan premiums by the Company. Employees electing to retire during 2004 will have a choice between the new and old plan, and employees retiring after December 31, 2004 will participate in the new plan.

The valuation of these post-employment benefits includes a health care cost trend rate of 10% per year in 2003 declining by 1% per annum to 5% per year in 2008 and thereafter.

These assumptions, including the post-employment benefit plan changes, have been included in the calculation of the Accrued Benefit Obligation at December 31, 2003.

12. Financing Costs

	2003	2002
Interest and expense on long-term debt	**$ 155.6**	$ 168.9
Interest on short-term debt	**29.0**	10.8
Interest capitalized	**(8.6)**	(18.9)
	$ 176.0	$ 160.8

13. Income Taxes

Provision for Income Taxes

	2003	2002
Current income taxes	**$ 49.6**	$ 52.6
Future income taxes	**9.4**	10.6
	$ 59.0	$ 63.2

Variation in Effective Income Tax Rate

Consolidated income taxes vary from the amount that would be computed by applying the Canadian and United States federal, and British Columbia and Alberta combined statutory income tax rate of 36.47% (2002–38.04%) to earnings before income taxes as shown in the following table:

	2003	2002
Earnings before income taxes	**$ 198.4**	$ 175.7
Combined statutory income tax rate	**36.47%**	38.04%
Combined income taxes at statutory rate	**$ 72.4**	$ 66.8
Increase (decrease) in income taxes resulting from:		
Capital cost allowance and other deductions claimed for income tax purposes over amounts recorded for accounting purposes	**(11.7)**	(12.4)
Large Corporations Tax in excess of surtax	**7.8**	6.7
Non-deductible expenses and non-taxable income	**(0.2)**	1.3
Benefit of tax rate changes on losses	**(3.3)**	(1.0)
Equity income not subject to tax	**(2.6)**	—
Other	**(3.4)**	1.8
Actual consolidated income taxes	**$ 59.0**	$ 63.2
Effective income tax rate	**29.74%**	35.97%

Future Income Taxes

The net future income tax liability of the Company of $67.5 million (2002–$58.1 million) relates primarily to the tax effect of temporary differences on non-regulated property, plant and equipment balances.

As a result of the Company accounting for income taxes following the taxes payable method for its regulated operations, the Company has not recognized net future income tax liabilities amounting to $327.1 million at December 31, 2003 (2002–$321.0 million) and has not recognized a future income tax expense of $10.3 million for the year ended December 31, 2003 (2002–$10.3 million), all of which were calculated using the asset and liability method.

14. Financial Instruments

Fair Value Estimates

The carrying values of cash and short-term investments, accounts receivable, short-term notes and accounts payable and accrued liabilities approximate their fair values due to the relatively short period to maturity of the instruments.

The estimated fair value of the Company's investment in the Express System approximates its carrying value.

The fair value of the Company's long-term debt, calculated by discounting the future cash flow of each debt issue at the estimated yield to maturity for the same or similar issues at December 31, 2003, or by using available quoted market prices, is estimated at $2,565.3 million (2002–$2,424.8 million). The majority of the Company's long-term debt relates to regulated operations, which enables the Company to recover the existing financing charges through rates or tolls.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment.

Derivative Instruments

The Company uses derivative instruments to hedge its exposures to fluctuations in natural gas prices, interest rates and foreign currency exchange rates.

As approved by the regulator, derivatives are used to manage natural gas price risk in the natural gas distribution operations. The majority of the natural gas supply contracts have floating rather than fixed prices. The Company uses natural gas price swap contracts to fix the effective purchase price. Any differences between the effective cost of natural gas purchased and the price of natural gas included in rates are recorded in a deferral account (GCRA), and subject to regulatory approval, are passed through in future rates to customers.

The Company's short-term borrowings and variable rate long-term debt are exposed to interest rate risk. The Company manages interest rate risk through the use of interest rate derivatives.

Foreign currency risk in natural gas distribution operations relates mainly to purchases and sales of natural gas denominated in U.S. dollars, and is thereby managed through the regulatory process. Certain foreign currency risks in the natural gas distribution operations are managed through the use of foreign currency derivatives on behalf of customers.

The Company's earnings from the U.S. portion of Trans Mountain's crude oil pipeline system and the Company's investment in the Express System are subject to foreign currency risk. The Company's earnings are also subject to translation risk associated with certain Express System assets and liabilities. The Company manages these foreign currency exposures through the use of foreign currency derivatives.

As at December 31, 2003, Terasen Gas had several outstanding foreign currency swaps, all of which expire in 2004. The carrying value of the foreign currency swaps at December 31, 2003 was a liability of $0.9 million. Terasen Gas had no foreign currency swaps outstanding at December 31, 2002.

The carrying value of natural gas derivatives at December 31, 2003 was a liability of $7.8 million (2002–asset of $0.2 million) and the fair value of the derivatives was an asset of $6.3 million (2002–$15.8 million). These derivatives have terms to maturity of up to two years as at December 31, 2003. The natural gas derivatives fair value reflects only the value of the natural gas derivatives and not the offsetting change in value of the underlying future purchases of natural gas. These fair values reflect the estimated amounts the Company would receive or pay to terminate the contracts at the stated dates.

As at December 31, 2003, TGVI had several interest rate swaps outstanding with terms of two to five years. The carrying value of the swaps at December 31, 2003 was a liability of $1.5 million (2002–$1.9 million) and the fair value of the interest rate swaps as at December 31, 2003 was a liability of approximately $4.8 million (2002–$11.3 million). The derivatives entered into by TGVI relate to regulated operations and any resulting gains or losses are recorded in a deferral account (RDDA), subject to regulatory approval, and passed through to customers in future rates.

As at December 31, 2003, the Company had two interest rate swaps outstanding with terms of approximately five years and two years. The carrying value of these derivatives was an asset of $0.4 million (2002–$0.2 million) and the fair value of these derivatives was an asset of $5.3 million (2002–$3.6 million). As at December 31, 2003, the Company had one U.S. dollar foreign currency derivative outstanding which is being used to mitigate foreign currency exposure in the investment in the Express System. The derivative expires in 2004 and the carrying and fair values of the derivative at December 31, 2003 was $0.8 million. The change in fair value of the derivative of $0.8 million has been included in the earnings contribution from the Express System. There were no significant foreign currency derivatives outstanding at the end of 2002.

The Company is exposed to credit risk in the event of non-performance by counterparties to derivative instruments. Because it deals with high credit quality institutions in accordance with established credit approval practices, the Company does not expect any counterparties to fail to meet their obligations.

15. Commitments

Terasen Gas, TGVI and Trans Mountain have entered into operating leases for certain building space and natural gas distribution assets. Minimum payments under these leases are on average approximately $20.0 million in each of the next three years, $64.4 million in 2007, $13.0 million in 2008 and $208.9 million in aggregate.

Included in these amounts are payments for operating leases for certain natural gas distribution assets which were sold in October 2001 and November 2002. The pre-tax gains of $34.6 million on combined cash proceeds of $71.3 million have been deferred and are being amortized over the 17-year terms of the leases.

16. Guarantees

The Company has, for a fee, arranged for the issuance of a letter of credit in the amount of US$6.4 million on behalf of a co-investor in the Express System to fund the Debt Service Reserve Account required under the Express System's trust indenture. The letter of credit is subject to annual renewal. If the letter of credit is drawn upon, the Company will have recourse to the co-investor, a major Canadian pension fund.

The Company has, for a fee, provided indemnities with respect to performance bonds issued on behalf of Clean Energy, a U.S. company in which the Company holds a 44.2% interest, in the amount of US$4.5 million. These performance bonds secure construction projects undertaken by Clean Energy, and have expiry dates of one year from the date of issue.

Unaudited
Dollar amounts in millions

Years ended December 31	**2003**	2002	2001	2000	1999
Statements of Earnings					
Operating revenue	**$ 1,876.6**	$ 1,707.2	$ 1,666.3	$ 1,305.6	$ 1,040.6
Operating expenses	**1,510.2**	1,370.7	1,371.1	1,049.0	784.7
Operating income	**366.4**	336.5	295.2	256.6	255.9
Other expenses	**176.0**	160.8	148.3	131.0	121.6
Share of earnings of Express System	**(8.0)**	—	—	—	—
Income taxes	**59.0**	63.2	55.9	8.9	48.4
Non-controlling interest	**—**	—	—	4.0	4.7
Net earnings	**139.4**	112.5	91.0	112.7	81.2
Capital securities distributions	**6.7**	6.7	6.4	3.9	—
Earnings applicable to common shares	**$ 132.7**	$ 105.8	$ 84.6	$ 108.8	$ 81.2
Assets					
Current assets	**$ 577.0**	$ 482.9	$ 503.5	$ 631.2	$ 270.7
Property, plant and equipment (net)	**3,882.4**	3,779.2	3,079.9	2,727.6	2,185.1
Investment in Express System	**204.6**	—	—	—	—
Other assets	**251.1**	260.3	122.3	154.3	25.1
Total assets	**$ 4,915.1**	$ 4,522.4	$ 3,705.7	$ 3,513.1	$ 2,480.9
Liabilities and Shareholders' Equity					
Current liabilities	**$ 1,014.1**	$ 878.9	$ 857.7	$ 1,094.4	$ 712.4
Long-term debt	**2,301.1**	2,123.4	1,928.0	1,561.9	1,001.8
Other long-term liabilities and deferred credits	**102.8**	96.4	23.1	—	—
Other liabilities	**67.5**	58.1	56.8	47.3	140.4
Shareholders' equity	**1,429.6**	1,365.6	840.1	809.5	626.3
Total liabilities and shareholders' equity	**$ 4,915.1**	$ 4,522.4	$ 3,705.7	$ 3,513.1	$ 2,480.9
Cash Flow Data					
Operating cash flow	**$ 269.8**	$ 318.1	$ 59.8	$ 179.3	$ 124.1
Capital expenditures	**$ 222.9**	$ 395.7	$ 469.8	$ 620.6	$ 163.6

Unaudited
Dollar amounts in millions

Years ended December 31	**2003**	2002	2001	2000	1999
Natural Gas Distribution Operations					
Revenues					
Residential	**$ 828.8**	$ 779.6	$ 813.6	$ 627.8	$ 493.2
Commercial	**409.6**	382.3	442.2	336.3	262.2
Small industrial	**77.6**	76.7	73.6	52.3	26.7
Large industrial and other	**33.7**	27.4	6.8	7.7	8.8
Total natural gas sales revenue	**$ 1,349.7**	$ 1,266.0	$ 1,336.2	$ 1,024.1	$ 790.9
Transportation	**90.9**	83.8	56.1	41.0	38.4
Other	**57.3**	52.9	28.0	20.3	15.4
Total natural gas revenue	**$ 1,497.9**	$ 1,402.7	$ 1,420.3	$ 1,085.4	$ 844.7
Natural gas volumes *(billion cubic feet)*					
Sales volumes	**116.7**	126.0	110.8	124.0	121.8
Transportation volumes	**57.9**	61.3	53.9	56.3	57.6
Throughput under fixed-price contracts	**20.9**	22.6	63.9	57.9	38.0
Total natural gas volumes	**195.5**	209.9	228.6	238.2	217.4
Customers at year-end	**859,183**	850,699	767,855	762,878	755,383
Rate base — Terasen Gas Inc.	**2,258.8**	2,233.7	2,207.9	1,689.5	1,637.4
— Terasen Gas (Vancouver Island) Inc.	**454.0**	450.9	N/A	N/A	N/A
	2,712.8	2,684.6	2,207.9	1,689.5	1,637.4
Petroleum Transportation Operations					
Revenues	**$ 200.0**	$ 136.0	$ 143.1	$ 132.5	$ 129.4
Transportation volumes *(barrels per day)*					
Trans Mountain					
Canadian mainline	**216,100**	201,200	209,300	204,600	207,500
U.S. mainline *(included in Canadian mainline)*	**54,600**	47,800	73,400	65,200	61,900
Express System	**171,200**	N/A	N/A	N/A	N/A
Kilometres of Pipelines					
Natural gas distribution operations	**43,777**	43,196	37,430	37,197	36,581
Petroleum transportation operations	**4,720**	1,477	1,477	1,477	1,477
Employees *(consolidated)*	**2,082**	2,051	1,782	1,966	1,869

Consolidated Financial Information (Five Years)

Unaudited

Years ended December 31		**2003**	2002	2001	2000	1999
Ratios						
Return on average common equity		**10.7%**	11.7%	12.1%	12.0%	12.2%
Dividend payout ratio		**0.60**	0.57	0.59	0.43	0.55
Interest coverage ratio		**2.1**	2.1	2.0	2.2	2.1
Debt to total equity		**67%**	66%	75%	71%	69%
Common shares outstanding						
— weighted average (millions)		**51.9**	43.2	38.3	38.3	38.3
Data per common share						
Earnings before non-recurring items		**$ 2.62**	$ 2.45	$ 2.21	$ 2.06	$ 1.94
Earnings after non-recurring items		**$ 2.56**	$ 2.45	$ 2.21	$ 2.84	$ 2.12
Dividends		**$ 1.530**	$ 1.410	$ 1.300	$ 1.225	$ 1.165
Operating cash flow		**$ 5.20**	$ 7.36	$ 1.56	$ 4.68	$ 3.24
Common equity		**$ 25.05**	$ 24.00	$ 18.65	$ 17.86	$ 16.36
Market price range	— High	**$ 48.50**	$ 42.50	$ 36.88	$ 33.50	$ 31.40
	— Low	**$ 36.15**	$ 32.55	$ 29.00	$ 21.50	$ 20.45
	— Close	**$ 47.95**	$ 38.16	$ 33.19	$ 33.35	$ 25.40

Quarterly Financial Information

Unaudited

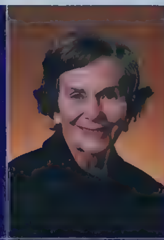
In millions, except where stated otherwise

	Three months ended				Year ended
2003	March	June	September	December	December
Revenues	**$ 556.0**	**$ 400.4**	**$ 304.5**	**$ 615.7**	**$ 1,876.6**
Net earnings (loss)	**$ 75.1**	**$ 9.8**	**$ (5.9)**	**$ 60.4**	**$ 139.4**
Earnings (loss) applicable to common shares	**$ 73.4**	**$ 8.2**	**$ (7.6)**	**$ 58.7**	**$ 132.7**
Data per common share					
Basic earnings (loss)	**$ 1.42**	**$ 0.16**	**$ (0.15)**	**$ 1.13**	**$ 2.56**
Diluted earnings (loss)	**$ 1.41**	**$ 0.16**	**$ (0.15)**	**$ 1.12**	**$ 2.53**
Dividends paid	**$ 0.36**	**$ 0.39**	**$ 0.39**	**$ 0.39**	**$ 1.53**
Common share trading — TSX					
High	**$ 39.99**	**$ 44.74**	**$ 44.94**	**$ 48.50**	**$ 48.50**
Low	**$ 36.15**	**$ 36.50**	**$ 41.75**	**$ 43.13**	**$ 36.15**
Close	**$ 36.95**	**$ 43.55**	**$ 43.50**	**$ 47.95**	**$ 47.95**
Volume	**4.6**	**6.2**	**5.7**	**4.1**	**20.6**
Common shares outstanding					
— weighted average	**51.7**	**51.9**	**51.9**	**52.0**	**51.9**

2002					
Revenues	$ 579.8	$ 351.2	$ 273.2	$ 503.0	$ 1,707.2
Net earnings (loss)	$ 69.4	$ 2.7	$ (17.4)	$ 57.8	$ 112.5
Earnings (loss) applicable to common shares	$ 67.8	$ 1.1	$ (19.1)	$ 56.0	$ 105.8
Data per common share					
Basic earnings (loss)	$ 1.70	$ 0.03	$ (0.44)	$ 1.23	$ 2.45
Diluted earnings (loss)	$ 1.69	$ 0.03	$ (0.44)	$ 1.22	$ 2.43
Dividends paid	$ 0.33	$ 0.36	$ 0.36	$ 0.36	$ 1.41
Common share trading — TSX					
High	$ 38.20	$ 41.99	$ 42.00	$ 42.50	$ 42.50
Low	$ 32.55	$ 36.55	$ 35.25	$ 35.80	$ 32.55
Close	$ 38.07	$ 40.10	$ 41.95	$ 38.16	$ 38.16
Volume	4.8	3.7	2.9	4.9	16.3
Common shares outstanding					
— weighted average	39.8	43.6	43.7	45.6	43.2

Mark L. Cullen
1, 2

Brian A. Canfield
1, 2



Marilyn E. Cassady
2, 3

Thomas S. Chambers
1, 2

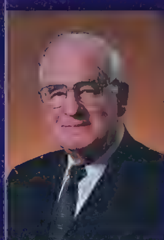
Pierre Choquette
1, 3

Ida J. Goodreau
3, 4

Eric P. Newell

Michael W. O'Brien
1, 3

John M. Reid



James M. Stanford
3, 4

Dr. David W. Strangway
2, 4

Douglas W.G. Whitehead
2, 4

Committees of the Board

1 Audit Committee **2** Corporate Governance & Nominating Committee
3 Environment and Safety Committee **4** Management Resources Committee
Terasen Inc. directors are also directors of Terasen Gas and Terasen Pipelines.

Mark L. Cullen, of Vancouver, British Columbia, is Chairman of the Board of Terasen Inc. and former Vice Chairman of RBC Dominion Securities. He is a director of Canfor Corporation, British Columbia Ferry Services Inc., and Wajax Limited. He joined the Board of Terasen in 1998.

Brian A. Canfield, of Point Roberts, Washington, is Chairman of TELUS Corporation and former Chairman, President and CEO of BC Telecom. He serves on the boards of Suncor Energy Inc., the T. S. Group and the Canadian Public Accountability Board. He joined the Board of Terasen in 1996.

Marilyn E. Cassady, of Vancouver, British Columbia, is an active member of the community. She is a director of the CKNW Orphans Fund and was formerly Chairman of the New Westminster Economic Development Association and Chairman of the Fraser River Discovery Centre. She joined the Board of Terasen Inc. in 1991.

Thomas S. Chambers, of Vancouver, British Columbia, is a corporate director of Senior Partner Services Ltd. and Chair of the B.C. Chapter of the Institute of Corporate Directors. He serves

Corporate Governance

Terasen's Board of Directors is composed exclusively of outside, independent directors with the exception of the President and Chief Executive Officer. The President and Chief Executive Officer, however, is not a member of any of the Board's Committees although the President and Chief Executive Officer is invited to attend Board and Committee meetings, except for the portions at each Board meeting which are held without management present.

The Board of Directors has, as its mandate, the responsibility for the stewardship of the Company on behalf of the shareholders.

The focus of the Terasen Board of Directors is to provide objective, prudent guidance to the Company. In developing and supervising implementation of the Company's strategic plan, the Board sets objectives for the Chief Executive Officer and the Company's senior management. The Company's responsibilities to its shareholders, customers and employees are demonstrated by its commitment to effective corporate governance and disclosure.

Terasen currently has four board Committees (an Audit Committee, a Corporate Governance & Nominating Committee, a Management Resources Committee and an Environment & Safety Committee). Each of these committees has been given a mandate by the Board

on the boards of Norske Skog Canada Limited, Elephant and Castle Group Inc., Mill and Timber Group, the National Ballet of Canada, the BC Cancer Foundation and the Victorian Order of Nurses, B.C. Branch. He joined the Board of Terasen in 2003.

Pierre Choquette, of Vancouver, British Columbia, is Chairman and CEO of Methanex Corporation. From 1994 to 2003 he was President and CEO of Methanex, and prior to this he held senior positions with NOVA Corporation and Polysar Ltd. Mr. Choquette is a member of the Canadian Council of Chief Executives. He joined the Board of Terasen in 2003.

Ida J. Goodreau, of Vancouver, British Columbia, is President and CEO of the Vancouver Coastal Health Authority. She is also a director of Shell Canada Limited. She previously held senior executive positions with Norske Skog, Fletcher Challenge Canada Limited, Tasman Pulp and Paper, and Union Gas Ltd. She joined the Board of Terasen in 2002.

Eric P. Newell, O.C. of Edmonton, Alberta, is Chairman of Careers: The Next Generation Foundation and is former Chairman and CEO of Syncrude Canada Ltd. He serves on the boards of Nexen Inc. and Canfor Corporation. He joined the Board of Terasen in 2004.

Michael W. O'Brien, of Canmore, Alberta, is a director of Suncor Energy Inc., PrimeWest Energy Inc., and Shaw Communications Inc. He is also a member of the Board of Trustees for the Nature Conservancy of Canada. He joined the Board of Terasen in 2002.

John M. Reid, of Vancouver, British Columbia, is President and CEO of Terasen Inc. Before joining Terasen, he worked with Scott Paper Limited in senior financial positions and as President and CEO. He is Chair of the Board of Governors of the University of British Columbia and a director of Methanex Corporation and the Conference Board of Canada. He is also a member of the Canadian Council of Chief Executives and the Business Council of B.C. He joined the Board of Terasen in 1997.

James M. Stanford, of Calgary, Alberta, is President of Stanford Resource Management Inc. and former President and CEO of Petro-Canada. He is Chair of the Canadian Foundation for Sustainable Development Technology Canada, and serves on the boards of EnCana Corporation, NOVA Chemicals Corporation, Inco Limited, OMERS Resources, Iogen Corporation and OPTI Canada Inc. He joined the Board of Terasen in 2001.

Dr. David W. Strangway, of Vancouver, British Columbia, is President and CEO of the Canada Foundation for Innovation. Before joining the Foundation, he was President of the University of British Columbia from 1985 to 1997. He has served on numerous scientific and academic committees. He joined the Board of Terasen in 1991.

Douglas W.G. Whitehead, of Vancouver, British Columbia, is President and CEO of Finning International Inc. Prior to joining Finning, he was President and CEO of Fletcher Challenge Canada Limited. He serves on the boards of Ballard Power Systems Inc., Belkorp Industries Inc., The Conference Board of Canada and the University of British Columbia. He is a member of the Canadian Council of Chief Executives. He joined the Board of Terasen in 2000.

Executive Officers

John M. Reid
President and Chief Executive Officer

Richard T. Ballantyne
President, Terasen Pipelines

Gordon R. Barefoot
Senior Vice President, Finance & Chief Financial Officer

Brett T. Hodson
President, Terasen Utility Services

Randall L. Jespersen
President, Terasen Gas

Patrick D. Lloyd
Senior Vice President, Human Resources & Government Affairs

Stephen J. Swaffield
Senior Vice President, Corporate Development

Stephen M.G. Richards
General Counsel, Chief Risk Officer & Corporate Secretary

of Directors with respect to certain specific stewardship responsibilities.

In the current environment, strong governance frameworks are critical not only to ensure organizational compliance and effectiveness, but increasingly to meet capital market expectations. Solid performance in this regard is essential today to gain access to low cost debt and equity capital. Investors and securities regulators expect full and continuous disclosure of financial results in accordance with Generally Accepted Accounting Principles. Terasen's governance model is predicated on meeting or exceeding these expectations.

Terasen is committed to meeting or exceeding the recommendations set out in the Toronto Stock Exchange Guidelines for Effective Corporate Governance. The Board continues to further its commitment to corporate governance through reviewing existing processes and, where appropriate, developing new ones to ensure Terasen's continuing excellence in this important area. Terasen has in place an organization and culture that embodies strong governance, focused management and employees, and appropriate motivation and reward incentives.

Annual General Meeting

The Annual General Meeting of Shareholders will be held at 11:00 a.m. on Thursday, April 22, 2004 at the Fairmont Waterfront Hotel in Vancouver, British Columbia.

Dividend Reinvestment and Share Purchase Plan

Registered holders of the Company's Common shares (except residents of the United States) may elect to reinvest their cash dividends in new Common shares. Participants in the Plan may also make optional cash payments of up to $20,000 per calendar year to purchase additional Common shares. Optional cash payments must be received by the Registrar and Transfer Agent by the last days of January, April, July and October to be reinvested on the following dividend payment date. There are no brokerage commissions payable on shares purchased pursuant to the Plan. For an information package on the Plan, or to register in the Plan, please contact Shareholder Relations.

Employee Share Purchase Plan

Employees of Terasen Inc. may contribute from 2% to 6% of their earnings through payroll deductions to purchase the Company's Common shares. Shares are purchased at 100% of the market price.

Common Share Distribution

Approximately 99.5% of the outstanding common shares are owned by residents of Canada. The following table summarizes the distribution of shares at December 31, 2003.

	Shareholders	Shares
Canada	6,097	56,407,622
USA	91	215,642
Others	32	46,207
Total	6,220	56,669,471

Common Shares

Valuation Day Value (December 22, 1971)
Common Shares[1] $6.50
February 22, 1994 Closing Price, $15.50

Registrar and Transfer Agent

Shareholder accounts, including dividend payments, direct deposit service and the transfer of shares are handled by the Company's registrar and transfer agent:

CIBC Mellon Trust Company

16th Floor, 1066 W Hastings Street
Vancouver, B.C. V6E 3X1
Telephone: (604) 688-4330
Toll Free: 1-800-387-0825
Fax: (604) 688-4301
Website: www.cibcmellon.com

Duplicate Annual and Interim Reports

To eliminate duplicate mailings of annual and quarterly reports, please contact CIBC Mellon Trust Company.

Shares Listed (Symbol: TER)

The Toronto Stock Exchange

Scheduled Dividend Payment Dates

February 29, 2004
May 31, 2004
August 31, 2004
November 30, 2004

[1] Adjusted for the two-for-one stock split on November 18, 1985.

Shareholder Relations

Inquiries regarding the Company's Dividend Reinvestment and Share Purchase Plan and all other inquiries or comments by shareholders regarding the Company should be directed to:

Debra Nelson
Tel: (604) 443-6559
Toll-Free (Canada): 1-800-667-9177
Fax: (604) 443-6630
E-mail: shareholder@terasen.com

Investor Relations

Portfolio managers, investment analysts and other investors requesting financial information regarding Terasen should contact:

David Bryson
Tel: (604) 443-6527
Fax: (604) 443-6673
E-mail: investor.relations@terasen.com

Internet

Website: www.terasen.com

Corporate Offices

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Terasen Pipelines
Suite 2700, 300-5th Avenue SW
Calgary, Alberta T2P 5J2
Telephone: (403) 514-6400

Terasen Utility Services
1128 Burdette Street
Richmond, B.C. V6V 2Z3
Telephone: (604) 273-4987

Project management: Arlette Communication Inc. Design: Signals Design Group. Printing: Metropolitan Fine Printers. Printed on recycled paper.

Terasen

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